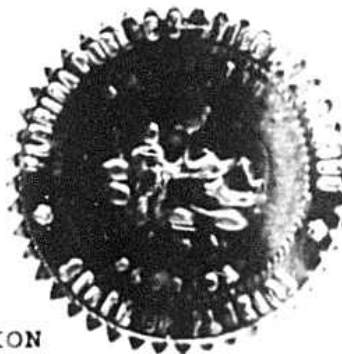


BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

 In the Matter of : DOCKET NO. 961173-TP
 :
 Petition by Sprint Communications :
 Company Limited Partnership d/b/a :
 Sprint for arbitration with GTE :
 Florida Incorporated concerning :
 interconnection rates, terms, and :
 conditions, pursuant to the :
 Federal Telecommunications Act :
 of 1996. :



FIRST DAY - MORNING SESSION

VOLUME 2

Pages 203 through 298

PROCEEDINGS: HEARING

BEFORE: COMMISSIONER DIANE K. KIESLING
COMMISSIONER JOE GARCIA

DATE: Thursday, December 5, 1996

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: H. RUTHE POTAMI, CSR, RPR
Official Commission Reporter
(904) 413-6734

APPEARANCES:

(As heretofore noted.)

DOCUMENTS TO DATE

13069 DEC-96

FLORIDA PUBLIC SERVICE COMMISSION

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WITNESSES - VOLUME 2

NAME	PAGE NO.
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EXHIBITS - VOLUME 2

NUMBER	ID.	ADMTD.
8	DES-1, DES-2	210

P R O C E E D I N G S

1
2 (Transcript follows in sequence from
3 Volume 1.)

4 COMMISSIONER KIESLING: We'll go back on the
5 record, and you may call your next witness.

6 MR. FINCHER: Call David Stahly to the
7 stand, please.

8 COMMISSIONER KIESLING: Did I swear you in
9 this morning?

10 WITNESS STAHLY: Yes, you did.

11 COMMISSIONER KIESLING: Well, then you don't
12 have to stand up for me.

13 - - - - -

14 DAVID E. STAHLY

15 was called as a witness on behalf of Sprint and,
16 having been duly sworn, testified as follows:

D I R E C T E X A M I N A T I O N

17
18 BY MR. FINCHER:

19 Q Would you state your name and business
20 address, please?

21 A My name is David Stahly. My business
22 address is 7301 West College Boulevard, Overland Park,
23 Kansas, 66212.

24 Q By whom are you employed and in what
25 capacity?

1 **A** I'm employed by Sprint Communications, L.P.
2 as a manager of regulatory policy.

3 **Q** Did you cause to be prepared and prefiled in
4 this proceeding your direct testimony consisting of 56
5 pages and two exhibits?

6 **A** Yes, I did.

7 **Q** Are there any corrections, additions or
8 deletions?

9 **A** Yes. Starting first with the direct
10 testimony --

11 **MR. FINCHER:** Excuse me. Commissioner, we
12 can either strike -- there's a few pages that need to
13 be stricken. We can either strike it or enter it --

14 **COMMISSIONER KIESLING:** Whichever.

15 **MR. FINCHER:** Whichever.

16 **COMMISSIONER KIESLING:** Sure.

17 **Q** **(By Mr. Fincher)** Either one.

18 **A** Okay. We'll go with the strike methodology.
19 On Page 2, sentence -- on Line 20, the last sentence
20 reading "I have testified," I'd like to strike that
21 sentence and replace it with another sentence, or
22 actually two sentences, reading as follows: "I have
23 testified before regulatory commissions in the states
24 of Arkansas, Georgia, Indiana, Kansas, Louisiana,
25 Oklahoma, Ohio, Tennessee and Washington.

1 Additionally, I have also taught courses on
2 telecommunications for the Center for Regulatory
3 Studies at the University of New Mexico."

4 The next strike would be on Page 52 starting
5 with Line 16 going through to Page 56, Line 12. That
6 would be all for the direct.

7 MS. BARONE: I'm sorry. What was the first
8 page on that?

9 WITNESS STAHLY: Page 52, Line 16 through
10 Page 56, Line 12.

11 Q (By Mr. Fincher) And did you also cause to
12 be prepared and filed in this proceeding your rebuttal
13 testimony consisting of 11 pages?

14 A Yes, I did.

15 Q Are there any corrections, additions or
16 deletions to that testimony?

17 COMMISSIONER KIESLING: I need you to slow
18 down, because I'm having trouble finding that.

19 MR. FINCHER: Okay.

20 COMMISSIONER KIESLING: That was mislabeled
21 as Mr. Sibley's testimony. Thank you.

22 WITNESS STAHLY: There are no strikes in
23 that. I have one sentence to insert on Page 3, Line
24 9, and that would be at the end of the sentence on
25 that line which ends "or network element that it

1 offers AT&T."

2 The new sentence would read, "Additionally,
3 Section 251(c) of the Act requires that rates for
4 interconnection and resale be nondiscriminatory.
5 Inasmuch as the Commission has set GTE's rates for
6 interconnection and wholesale rates in Dockets
7 96-0847-TP and 96-0980-TP, for AT&T and MCI it would
8 be discriminatory to allow GTE to charge Sprint
9 different rates for the exact same services."

10 And then the next sentence would be
11 modified, which is Line 10. "I am willing to accept
12 all of the prices arbitrated in that -- would strike
13 "that" and insert "the GTE and AT&T agreement." And
14 then I have no other changes to the rebuttal
15 testimony.

16 Q (By Mr. Fincher) That completes all your
17 additions, corrections and deletions?

18 A Yes.

19 COMMISSIONER KIESLING: May I just clarify
20 where you remove the word "that --

21 WITNESS STAHLY: Yes.

22 COMMISSIONER KIESLING: -- on Line 10 and
23 inserted "the GTE and AT&T agreement," are you also
24 removing the word "agreement" on an interim basis?

25 WITNESS STAHLY: No, I'm not.

1 **COMMISSIONER KIESLING:** Well, then the
2 sentence doesn't make any sense.

3 **WITNESS STAHLY:** It's saying "agreement,
4 agreement?"

5 **COMMISSIONER KIESLING:** Yes.

6 **WITNESS STAHLY:** Well, strike one of the --

7 **COMMISSIONER KIESLING:** "All the prices
8 arbitrated in the GTE and AT&T agreements, agreement
9 on an interim basis?"

10 **WITNESS STAHLY:** It should read, "arbitrated
11 in the GT&T -- GTE and AT&T agreements on an interim
12 basis."

13 **COMMISSIONER KIESLING:** Agreements; okay.
14 Thank you.

15 **WITNESS STAHLY:** I'm sorry if I confused
16 you.

17 **COMMISSIONER KIESLING:** Okay. I'm with you.

18 **Q** **(By Mr. Fincher)** If I asked you the same
19 questions as set out -- as corrected, and with the
20 additions as set out in your prefiled direct and
21 rebuttal testimony, would your answers be the same?

22 **A** Yes, they would.

23 **MR. FINCHER:** Commissioner, can I have the
24 testimony of Mr. Stahly as identified moved into the
25 record as if given orally from the stand?

1 **COMMISSIONER KIESLING:** Yes. The amended
2 direct and amended rebuttal of Mr. Stahly will be
3 inserted in the record as though read.

4 **MR. FINCHER:** Thank you.

5 **MR. FINCHER:** And with respect to
6 Mr. Stahly's direct testimony, there were two
7 exhibits, DES-1 and DES-2. Could I have those
8 identified for the record, please?

9 **COMMISSIONER KIESLING:** Yes. They will be
10 identified as Composite Exhibit 8.

11 (Exhibit 8 marked for identification.)

12

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

DAVID E. STAHLY

ON BEHALF OF

SPRINT COMMUNICATIONS COMPANY
LIMITED PARTNERSHIP

1 Q. Please state your full name and business address.

2

3 A. My name is David E. Stahl. My office address is 8140 Ward Parkway, Kansas City,
4 Missouri, 64114.

5

6 Q. What is your position?

7

8 A. I am employed by Sprint Communications Company Limited Partnership ("Sprint") as a
9 Policy Manager.

10

11 Q. Please describe your educational background, work experience and present
12 responsibilities.

13

1 A. I received a Bachelor of Arts degree in Economics from Brigham Young University in
2 1985 and Master of Arts degree in Public Policy from the University of Chicago in 1987

3
4 I began working for Sprint in 1994 as a Manager of Regulatory Access Planning. In that
5 position, I represented Sprint before state and federal regulatory commissions regarding
6 access issues and Sprint's negotiated access pricing and rate structures with the local
7 exchange carriers ("LECs")

8
9 Prior to joining Sprint's Long Distance Division, I was employed by Sprint Corporation's
10 local telephone affiliate, Sprint-United North Central ("UNC") from 1990 to 1994. In that
11 capacity, I was responsible for costing and pricing switched and special access services.
12 While at UNC, I also conducted competitive analyses. Prior to joining Sprint, I worked
13 for the Illinois Commerce Commission as an Executive Assistance to the
14 Commissioners from 1986 to 1990. In that capacity, I provided financial and economic
15 analyses of telecommunications, gas and electric utility issues and I assisted in the
16 preparation of orders and opinions.

17 My current responsibilities include coordinating with representatives of Sprint business
18 units regarding regulatory matters, contributing to the development of Sprint regulatory
19 policy, and testifying on behalf of Sprint concerning economic and regulatory policy in
20 telecommunications. I have testified before ^{regulatory commissions in the} ~~the Arkansas Public Service Commission,~~
21 ~~the Georgia Public Service Commission, the Oklahoma Corporation Commission, and~~
22 ~~the Washington Utility and Transportation Commission~~ states of Arkansas, Georgia, Indiana, Kansas, Louisiana,
23 Oklahoma, Ohio, Tennessee and Washington. Additionally, I have also taught courses on telecommunications for the Center for Regulatory Studies at the University of New Mexico.

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Q. What is the purpose of your testimony?

A. The purpose of my testimony is to describe Sprint's position on all of the pricing issues that have been unresolved in negotiations over the interconnection agreement between Sprint and GTE Florida Incorporated ("GTE"). The testimony will cover cost-based pricing for interconnection, unbundled network elements, and transport and termination of traffic including discussion of interim rates and the establishment of permanent rates under the TELRIC-based pricing methodology. In addition, the testimony will cover wholesale pricing including discussion of the avoided cost methodology established by the Federal Communications Commission ("FCC"). Finally, the testimony will cover important pricing parity issues, including the application of volume discounts, the application of non-recurring charges, and pricing related to interim number portability.

I. TELRIC-based Pricing Methodology

(A) Summary of Position - TELRIC-based Pricing Methodology

Q. Has GTE provided cost studies that satisfy the requirements of the Telecommunications Act of 1996 (the Act) and the FCC's First Report and Order released August 8, 1996 in CC Docket No. 96-98 ("FCC Order")?

1 A. No. Sprint will need to file further testimony when TELRIC-based cost studies are
2 provided.

3

4 **Q. What does the Act require for pricing interconnection and network elements?**

5

6 A. The Act requires that Incumbent Local Exchange Company (ILEC) prices for
7 interconnection and network elements shall be based on cost (without reference to any
8 rate-base proceeding) and be nondiscriminatory, and may include a reasonable profit.
9 Section 252(d)(1).

10

11 **Q. What does the FCC Order require for pricing of interconnection and network
12 elements?**

13

14 A. The FCC Order requires that interconnection and unbundled elements be priced based
15 on the sum of total element long run incremental cost (TELRIC) and a reasonable
16 allocation of forward-looking common costs. (51.505)

17

18 **Q. Please describe Sprint's pricing policy for interconnection and network elements.**

19

20 A. Sprint believes that prices for interconnection and network elements must be based on
21 economic cost. More specifically, Sprint recommends:

22

- 1 » Prices for interconnection and unbundled elements should be developed using
2 the TELRIC-based pricing methodology established by the FCC.
3
- 4 » The level of contribution to common costs should be a uniform loading that is
5 limited to a level that reflects the common costs of an economically efficient local
6 exchange carrier.
7
- 8 » The reasonable profit level to be included in TELRIC should be the most recent
9 authorized intrastate rate of return or prescribed interstate rate of return.
10
- 11 » Prices for network elements should be geographically deaveraged; for example,
12 according to high cost, medium cost, and low cost areas
13

14 (B) TSLRIC

15 Q. Please explain what is meant by TSLRIC?
16

17 A. Total Service Long Run Incremental Cost, or TSLRIC, represents the incremental cost
18 of an entire product.¹ In other words, TSLRIC represents all the costs directly caused
19 by a service. TSLRIC is also sometimes called total incremental cost, long run service
20 incremental cost, long run incremental cost - total service, or average incremental cost

¹ William J. Baumol, *Superfairness* 113 (1986)

1 (when divided by output).² TSLRIC includes all of the service-specific fixed costs and
2 volume sensitive costs. It represents the total burden that the service places upon the
3 resources of the company. In more precise terms, TSLRIC is the difference between (1)
4 the total cost of a company that provides the service and a number of others, and (2)
5 the total cost of that same company if it provided all of its other services in the same
6 quantities, but not the service in question.

7
8 **Q. Why is it appropriate to include TSLRIC in prices for interconnection and network**
9 **elements?**

10
11 **A.** TSLRIC is an appropriate basis for rates because it represents the economic cost of all
12 of the resources the ILEC is using solely to provide the interconnections and network
13 elements. Using TSLRIC ensures that the costs the interconnections and/or network
14 elements cause are not being covered by other services. Most importantly, as a
15 measure of forward-looking economic cost, TSLRIC best replicates the conditions of a
16 competitive market and reduces the ability of an incumbent LEC to engage in anti-
17 competitive behavior.

18
19
20

² William J. Baumol & J. Gregory Sidak, *Toward Competition in Local Telephony* 57-8 (1994)

1

2

(C) TELRIC

3

Q. Is TSLRIC costing different from TELRIC costing?

4

5

A. Essentially, TSLRIC and TELRIC costing methodologies are the same. Their differences are related to the items being costed, not the method of developing the costs. More specifically, TSLRIC studies determine the forward-looking, long run incremental cost of **services** while TELRIC studies determine the forward-looking, long run incremental cost of **network elements**. The FCC chose the term total "element" long-run incremental cost to reflect that the "services" in question are, in reality, "elements" of the network. The FCC also noted that unlike telecommunication services, network elements correspond to distinct network facilities (paragraph 678)

13

14

Q. Please describe the TELRIC-based pricing methodology as defined in the FCC Order.

15

16

17

A. The TELRIC-based pricing methodology defined by the FCC requires prices to be set to recover the following categories of costs:

18

19

20

I. Directly attributable incremental cost of the element (TELRIC)

21

a) Incremental costs of facilities and operations dedicated to the element

22

b) Incremental costs of shared facilities and operations

1 II. A reasonable allocation of common costs

2
3 The directly attributable incremental cost of the element would be determined via an
4 *appropriately developed* TELRIC cost of service study. Sprint's position on an
5 appropriate allocation of common costs will be defined below

6
7 **Q. Please describe Sprint's position on an appropriately developed TELRIC cost of**
8 **service study.**

9
10 A. The FCC clearly defines several characteristics of an appropriately developed TELRIC
11 cost of service study. These characteristics should be reflected in any study submitted
12 to the Commission for its approval. An appropriately developed TELRIC study

13
14 1) Will include the long run, incremental costs caused by or directly attributable to the
15 specific element. This will include both costs caused by facilities and operations
16 dedicated to the element and those facility and operations costs shared by a group
17 of elements.

18 2) Will reflect per-unit costs derived from total costs using reasonable, accurate fill
19 factors.

20 3) Will reflect current wire center location and the most efficient technology available

21 4) Will include a reasonable return on investment, e.g. profit.

22 5) Will reflect economic depreciation rates.

1 6) Will not include embedded costs, retail costs, opportunity costs or subsidies to other
2 elements or services.

3
4 The FCC's order requires ILEC's to "explain with specificity why and how specific
5 functions are necessary to provide network elements and how the associated costs
6 were developed." (paragraph 691) Restated, the burden of proof is on the ILEC to
7 substantiate all costs included in its TELRIC studies. Since Sprint has not been afforded
8 the opportunity to review GTE's TELRIC studies, it reserves the right to submit future
9 testimony related to those cost studies once it has reviewed those studies and made its
10 determination of whether the requirements of the FCC order have been satisfied

11
12 **Q. Please describe what is meant by "costs directly attributable to the specified
13 element".**

14
15 **A.** The FCC defined directly attributable forward-looking cost to include incremental
16 investment costs and expenses dedicated to the element as well as the incremental
17 costs of facilities and operations costs that are shared by a set of network elements.
18 Directly attributable costs, then, are costs incurred specifically in the provision of a
19 particular network element. To the extent that certain network elements share facilities
20 or operations, these shared costs are included in the TELRIC of that set of elements
21 and are to be attributed to specific network elements in reasonable proportions. To use
22 the FCC's example, conduit that is used for both interoffice transport and loops may be
23 apportioned to both the interoffice transport network element and to the local loop

1 element. Unless it can be demonstrated that a cost is dedicated to the provision of a
2 particular network element (or set of elements) it cannot be included in the TELRIC of
3 the element (or set of elements).

4 5 **(D) Common Costs**

6 **Q. What are common costs?**

7
8 **A** Common costs are one type of shared cost. Shared costs are costs that are

9 » shared by more than one service,

10 » incremental to a set of services sharing the costs, and

11 » unaffected by any subset of the services sharing the costs

12
13 Another way of saying this is that shared costs are essential to the provision of more
14 than one service and do not vary with the output of any of the services

15
16 There are two basic types of shared costs:

- 17
- 18 ▪ *Shared incremental costs* -- shared costs that are specific to only some services.
19 For example, loops and transport may share conduit, but these costs are not
20 shared with unbundled local switching. TELRIC includes shared incremental
21 costs.
- 22

- 1 ▪ *Overhead shared costs* -- These are common costs. They are shared by all
2 services. These are costs that do not change or go away unless the company
3 goes out of business. The classic example is the president's desk. TELRIC
4 does not include overhead shared costs

5
6 **Q. In the TELRIC-based pricing methodology, what is meant by "forward-looking
7 common costs"?**

8
9 **A. Under the TELRIC-based pricing methodology, forward-looking common costs represent
10 the other component, along with TELRIC, to be included in ILEC prices. These costs
11 are not specific or directly attributed to an element or set of elements. Also, since
12 interconnection and network elements are intermediate products, and not retail service
13 offerings, such costs as marketing, billing, and other retail related costs are not relevant
14 common costs. The only relevant common costs, then, are those costs that are
15 incurred in the overall operation of the firm, e.g. executive salaries. These costs are
16 common to all services and specific to none. The adoption of the standard of using
17 "forward-looking" common costs means that prices cannot be based on historical (i.e.
18 embedded or accounting) common costs. This is consistent with established economic
19 cost principles and the overall forward-looking economic cost paradigm adopted by the
20 FCC.**

1 **(E) Contributions to Common Costs**

2 **Q. Does the FCC provide any direction related to the size of common costs to be**
3 **included under the TELRIC-based pricing methodology?**

4
5 **A.** Yes. The FCC concluded that common costs should be smaller for network elements
6 than for services since network elements correspond to discrete network facilities that
7 have distinct operating characteristics. Also, under the TELRIC methodology, many
8 facilities costs that may be common with respect to "services" will be directly attributed
9 to the facilities when offered as unbundled network elements. The FCC also stated that
10 a properly conducted TELRIC methodology will attribute costs to specific elements to
11 the greatest possible extent, which will reduce the amount of common costs.

12
13 **Q. Does the FCC provide any guidance with respect to the allocation of common**
14 **costs?**

15
16 **A.** Yes. The FCC deemed two allocation methods to be reasonable and rejected another.
17 The two reasonable methods include:

18
19 » the use of a fixed allocation, such as a percentage markup over the directly
20 attributable forward-looking costs

1 » the allocation of only a relatively small share of common costs to certain critical
2 network elements, such as the local loop and collocation, that are most difficult
3 for entrants to replicate promptly (i.e. bottleneck facilities)
4

5 The FCC explicitly rejected allocations that rely on allocating common costs in inverse
6 proportion to the sensitivity of demand for various network elements. They concluded
7 that such allocation methods undermine the pro-competitive objectives of the Act.
8

9 **Q. What is Sprint's recommendation on the size and allocation of common costs?**

10

11 A. Sprint recommends that the contribution to common costs be set as a percentage
12 markup above the TELRIC of the element to reflect the forward-looking shared costs of
13 a reasonably efficient firm.
14

15 **Q. Why is it appropriate to include any common costs in interconnection prices?**

16

17 A. Including a portion of these costs is appropriate because revenues from products must
18 generally make a contribution to covering common costs if a company is to produce the
19 product. This is true both from a business perspective and an economic perspective.
20

21 **Q. Please explain the business perspective.**

22

1 A The most common pricing practice in business is to include a contribution to shared
2 costs in prices.³ Businesses determine the appropriate contribution several ways. The
3 most common way is to simply apply a uniform markup above the incremental cost.
4 This is often criticized as not being in the best interest of the company because the
5 company could make more money if it varied its markups on the basis of competitive
6 pressures.⁴ However, when the company is a monopoly or at least has significant
7 market power, it is not in the customers' interests nor in the public interest for the
8 company to be allowed to maximize its profits by having high markups in non-
9 competitive markets relative to markups in competitive markets. In fact, one of the
10 primary purposes of regulation is to keep this from happening.

11

12 This is one of the reasons why Sprint believes that regulation should require ILECs to
13 price interconnection and network elements in non-competitive markets just like they
14 would if all of their markets were fully competitive. By treating all markets as equally
15 competitive, ILECs would include no more than an average contribution to common
16 costs in prices for non-competitive services such as interconnection and network
17 elements.

18

19

20

³ James L. Pappas & Mark Hirschey, *Managerial Economics* 573-84 (1990)

⁴ Pappas & Hirschey, *Managerial Economics* 575-84 (1990)

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Q. Please explain the economic perspective.

A. From an economic perspective, prices need to make a contribution to common costs to ensure that the prices are sustainable. The technical definition of sustainable prices is prices that: (1) allow an efficient company to earn normal profits, (2) do not invite competition from less efficient companies, (3) do not require a cross-subsidy, and (4) result in an efficient market.⁵ In this case, an efficient market is one that provides the lowest overall cost of producing the industry's products. Sustainable prices allow a company to compete in a market and earn a normal profit.

Q. How much common cost should be included in interconnection prices?

A. The amount that interconnection prices should be marked up should be based on the amount of forward-looking common costs a company has relative to its overall costs. Conceptually, the markup would be calculated by dividing the company's economic common costs by the sum of its TSLRICs.

⁵ This definition is adapted from William J. Baumol, et al., *Contestable Markets and the Theory of Industry Structure* 314 (1988).

1 **Q. Why is a uniform markup appropriate for allocating common costs?**

2

3 A. There are two reasons. First, a uniform markup treats the non-competitive markets as if
4 they were competitive. This helps keep ILECs from using revenues from non-
5 competitive markets to finance competitive responses in competitive markets. The
6 second reason is that uniform markups are nondiscriminatory. Section 252(d)(1)(A)(ii)
7 of the Act requires that prices for interconnection and network elements be
8 nondiscriminatory. Price discrimination exists when markups vary among classes of
9 customers.⁶ The Act does not allow for degrees of discrimination. For example, the Act
10 does not state that prices should not be unreasonably discriminatory. The Act simply
11 allows for no discrimination.

12

13 **Q. You said that the markup should be limited to reflect the common costs of an**
14 **economically efficient local exchange carrier. Why should the markup be limited?**

15

16 A. Limiting the markup serves two purposes. First, it provides incentives for ILECs to
17 become more efficient. Basing prices on ILECs' own costs does not provide ILECs the
18 same efficiency incentives as pure price regulation or competition. This is true even if
19 the costs are measured as economic costs rather than as accounting costs as has been
20 done in rate of return regulation. A maximum contribution improves the efficiency
21 incentives. The second purpose of the maximum markup is to provide a limit on the

⁶ Pappas & Hirschey, *Managerial Economics* 573-84 (1990)

1 costs that can be charged to competitors. ILECs have an incentive to charge high
2 prices to competitors. These high prices give ILECs a financial advantage over their
3 competitors by increasing the ILECs' margins relative to their competitors' margins.
4 Limiting the markup helps limit the prices that ILECs can charge to competitors.

5
6 **Q. Has Sprint reviewed any measures of common costs?**

7
8 **A.** Yes. Sprint has reviewed two sources of public data that reflect accounting measures of
9 costs that are generally common in nature. These measures do not reflect an
10 appropriate approach for defining common costs in accordance with the FCC rules
11 because they are historical accounting costs, not forward-looking economic common
12 costs. However, these analyses may provide a benchmark that can be used in
13 evaluating the reasonableness of proposed common cost levels.

14
15 First, Sprint reviewed accounting data reported to the FCC by Tier 1 ILECs. A Tier 1
16 ILEC is an ILEC with more than \$100,000,000 in annual revenues. The data reviewed
17 was for 1995. This analysis is provided in EXHIBIT 1. This analysis shows that, on
18 average, Tier 1 ILECs' Corporate Operations Expenses (Account 6700) are about 16%
19 of Total Operating Expenses. And, on average, Tier 1 ILECs' General Support Plant
20 (Account 2100) is about 15% of Total Telecommunications Plant in Service.

21
22 The second analysis is from Ex Parte materials filed by Southwestern Bell in the Matter
23 of Federal-State Joint Board on Universal Service CC Docket No. 96-45. The analysis

1 is provided in EXHIBIT 2, showing that Southwestern Bell calculates its own Total
2 Common Costs to be 11% of its Total Costs

3
4 **(F) Return on Investment**

5 **Q. Please describe cost of capital?**

6
7 A. Cost of capital is what a company has to pay creditors and shareholders for the money
8 the company uses. The payment to creditors is generally called interest. The payment
9 to shareholders is generally called profit.⁷ Regulation and economic texts have long
10 recognized that there is a normal level of profit, or return on investment, that
11 shareholders need to receive if they are to continue to invest in the company. This
12 normal level of profit is often referred to as the cost of equity.⁸

13
14 **Q. Is cost of capital part of TELRIC?**

15
16 A. Yes. The incremental cost of network elements includes the cost of making additional
17 investments. The money to make these investments comes from creditors and
18 shareholders. As I explained above, the cost of obtaining money from creditors and
19 shareholders is called the cost of capital.

20

⁷ James L. Pappas & Mark Hirschey, *Managerial Economics* 10 (1990)

⁸ Pappas & Hirschey, *Managerial Economics*, 10, 652-3 (1990)

1 Q. Does TELRIC include profit?

2

3 A. Yes. TELRIC provides for a reasonable profit consistent with Section 252(d)(1) which
4 states that rates for interconnection and network elements "may include a reasonable
5 profit." Because TELRIC includes the cost of capital, TELRIC includes a normal level of
6 profit. The FCC concluded that the cost of capital included in TELRIC is equal to normal
7 profit and that allowing anything greater than normal profits would not be "reasonable"
8 under sections 251(c) and 251(d)(1).

9

10 Q. What is Sprint's recommendation regarding the level of return on investment
11 included in TELRIC?

12

13 A. The return level should be the most recent authorized intrastate rate of return or
14 prescribed interstate rate of return. The FCC concluded the following

15

16 » the currently authorized rate of return at the federal or state level is a reasonable
17 starting point for TELRIC calculations.

18

19 » ILECs bear the burden of demonstrating with specificity that the business risks of
20 providing interconnection and unbundled elements (which are generally
21 bottleneck, monopoly services that do not now face significant competition)
22 would justify a different risk-adjusted cost of capital.

23

1 (G) Other TELRIC Considerations

2 Q. Please describe what is meant by "reasonably accurate fill factors"

3
4 A. Fill factors are the percentage of available network capacity utilized. These factors arise
5 from the fact that when engineering and building of telecommunications facilities, LECs
6 attempt to anticipate future needs. For example, when deploying loop plant, if the
7 immediate need is 800 underground loops, a LEC may place enough loop plant to
8 facilitate 1,000 loops in anticipation of future demand. It is more cost-effective to dig a
9 trench once and allow for some excess than to dig up the trench every time a new loop
10 is required. In this example, the fill-factor would be 80% (800 loops in use divided by
11 1,000 loops available). Efficient deployment balances the cost-benefit of excess
12 capacity. On the one hand, not enough excess results in inefficient rework (e.g. digging
13 new trenches every month). On the other, too much excess is an inefficient use of
14 resources (e.g. burying plant that will never be used)

15
16 The FCC described reasonably accurate fill factors as estimates of the proportion of a
17 facility that will be "filled" with network usage and concluded that per-unit costs be
18 derived by dividing the total cost associated with the element by a reasonable projection
19 of the actual total usage of the element.

20
21 Fill factors are important because they effect unit costs; a low fill factor increases unit
22 cost, while a high fill factor lowers unit costs. A starting point for determining TELRIC fill

1 factors should be the actual "fills" of the ILEC. However, since these fills reflect
2 historical usage levels, they need to be examined for their reasonableness to be used
3 for projections as required by the FCC Order. Using the historical fills as a starting
4 point, the following issues should be considered in developing projected fills. First, to
5 the extent that an ILEC has overbuilt excess capacity in anticipation of entering new
6 lines of business, e.g. interLATA, historical fills will be too low as a basis for pricing
7 elements for the provision of local services. Second, efficient and effective competition
8 (which will only occur if element prices are cost-based) will result in new innovative local
9 service offerings and drive retail rates to competitive levels, which will in turn change
10 past usage patterns and stimulate overall demand. Third, competition should provide a
11 catalyst for a new level of efficiency in every aspect of the incumbent LECs' business,
12 including engineering and plant placement. These efficiencies may not be reflected in
13 historical fills factors. In summary, appropriate fills should reflect efficient engineering
14 practices. While the existing fills may represent a reasonable approximation of
15 projected fills, the fills used in TELRIC pricing must take into account 1) ILEC overbuilds
16 in anticipation of lines of business outside the scope of local service, 2) future changes
17 in usage patterns and overall demand stimulation, and 3) overall increases in ILEC
18 efficiency.

19
20 **Q. What is the significance of applying a standard that requires the use of "current**
21 **wire center locations and the most efficient technology available"?**
22

1 A. Forward-looking cost measurements require capturing the costs of network facilities that
2 will be incurred in the future. The use of current wire center locations and the most
3 efficient technology available in determining forward-looking economic costs is the
4 approach that reasonably balances the interests of ILECs, CLECs, and consumers
5 ILECs need prices that will recover their legitimate forward-looking economic costs
6 CLECs need to be provided the opportunity compete on an equitable basis with the
7 ILEC. Consumers will benefit the most when there is facilities-based competition. The
8 FCC explicitly rejected alternative approaches which represented extreme viewpoints
9 that would either frustrate facilities-based competition on the one hand or hinder
10 competitive entry on the other. Specifically, the FCC rejected the use of a hypothetical,
11 least cost, most efficient network in calculating forward-looking element costs at one
12 extreme, because this would discourage facilities-based competition, i.e. the incentive to
13 build would be reduced if facilities were already available at least-cost prices. At the
14 other extreme, the FCC rejected cost recovery based entirely on the past network
15 design and technology (i.e. embedded cost), because this would result in inefficient
16 pricing to the detriment of competitive entry. Instead, the FCC adopted a standard that
17 uses the existing wire center locations and the most efficient technology deployed as
18 most closely representing the incremental costs incumbent LECs will actually incur in
19 making elements available to new entrants.

20
21 **Q. Please expand on the use of economic depreciation rates.**
22

1 A The use of economic depreciation rates in TELRIC simply ensures that costs represent
2 the actual useful economic lives of ILEC facilities, instead of regulatory lives. The actual
3 useful economic lives may be different than that reflected in the existing prescribed
4 depreciation rates. However, the FCC Order concluded that the ILEC bears the burden
5 of demonstrating with specificity that different depreciation rates are justified (paragraph
6 702)

7

8

9 **Q. Why did the FCC reject considerations of embedded costs, retail costs,
10 opportunity costs, and subsidies?**

11

12 A In general, the FCC rejected these considerations as inconsistent with the cost-based
13 pricing standard established by the Act and as inconsistent with pro-competitive goals

14

15 Embedded costs, also referred to as accounting costs, represent the past expenditures
16 of a firm in providing a product. Because the inputs (materials, labor, capital) to a firm's
17 production change over time and because new technologies are introduced, the past
18 expenses and capital expenditures recorded on a firm's books will not be reflective of
19 the costs the firm will incur in the future. In order to encourage efficient entry, the FCC
20 concluded that forward-looking economic costs provide the appropriate basis for prices
21 potential entrants should pay for elements. In essence they found the use of embedded
22 costs to be contrary to the expedient development of competition

23

1 The FCC rejected the inclusion of retail costs in TELRIC-based prices based on the
2 nature of what is being provided. Network element facilities and functions will be
3 provided as intermediate products to requesting carriers. Therefore, since network
4 elements are not retail products, retail costs cannot be included in the price.

5
6 Many incumbent LECs argued for the inclusion of opportunity costs in element prices, in
7 essence, wishing to replace revenue lost when a new entrant provides retail service in
8 place of the incumbent LEC. The FCC rejected the inclusion of opportunity costs as
9 inappropriate to the goal of driving prices to competitive levels because the existing
10 retail prices that would be used to compute opportunity costs are not cost based.

11
12 Inclusion of subsidies in the prices for interconnection and network elements would
13 result in prices that are not cost-based, in violation of the Act's clear pricing standard.

14 15 **(H) Geographic Deaveraging**

16 **Q. What does Sprint propose with regard to geographic deaveraging?**

17
18 **A.** Sprint believes that ILECs should geographically deaverage prices for network
19 elements. Switching and transport costs are a function of traffic density and should be
20 deaveraged to high cost, medium cost, and low cost exchanges based on traffic density
21 characteristics. Loop costs are a function of loop length and the density of end-user
22 locations. These loop cost characteristics should be reflected in deaveraged prices that

1 may vary from the geographic areas used for switching and transport deaveraging. For
2 example, a low cost exchange with regard to switching may have both high and low loop
3 costs.

4
5 **Q. Why is this important?**

6
7 **A.** Deaveraged rates more closely reflect the actual costs of providing interconnection and
8 network elements because these costs can vary widely across a large geographical
9 area, for example, a study area that is composed of both densely populated and
10 sparsely populated areas. In keeping with the cost-based pricing standard of the Act,
11 the FCC concluded that rates for interconnection and unbundled elements must be
12 deaveraged and established a requirement of at least three cost-related rate zones.
13 Deaveraging is important because it provides accurate market signals. Whereas
14 geographic averaging, on the other hand, distorts competitors' entry decisions regarding
15 whether to build or lease unbundled network elements.

16
17 **II. Interconnection and Access to Unbundled Network Elements**

18 **(A) Summary of Position**

19 **Q. What is Sprint's position regarding the pricing of interconnection and unbundled**
20 **network elements?**

1 A. Sprint recommends the establishment of permanent rates reflecting the TELRIC-based
 2 pricing methodology discussed in detail previously in my testimony. With respect to
 3 interim prices, Sprint recommends that the default prices established in the FCC Order
 4 be applied until permanent rates are developed under the TELRIC-based pricing
 5 methodology.

6

7 **(B) Default Prices**

8 **Q. Please provide the default prices for interconnection and unbundled elements.**

9

10 A. In the absence of cost-based prices established under the TELRIC-based pricing
 11 methodology, the following default prices should be applied.

12

13 <u>Element</u>	Rate
14 Local Loops	\$16.71
15 Local Switching	\$0.003 per minute
16 Dedicated Transport	Tariffed interstate entrance facility and direct-trunked 17 transport charges
18 Common Transport	Weighted average per minute equivalent of dedicated 19 transport rate (as described in FCC 51.513(c)(4))
20 Tandem Switching	\$0.0015 per minute
21 Collocation	Tariffed interstate expanded-interconnection charges
22 Signaling, call-	Tariffed interstate charges where available

1 related databases

2

3 **Q. Why is it important to establish interim prices?**

4

5 A. Sprint encourages the Commission to undertake and conclude proceedings to establish
6 permanent rates under the TELRIC-based pricing methodology as quickly as possible.

7 However, to the extent that cost studies that satisfy the criteria of the Act and FCC

8 Order have not been developed and provided for thorough review, the interim prices

9 provide a means for establishing interconnection and accessing network elements

10 without delay.

11

12 **Q. The default local switching price you recommend is in the middle of the range set
13 by the FCC, why is that?**

14

15 A. Although the FCC stated that, in its review of the record evidence in the 96-98
16 proceeding, the most credible studies fell at the lower end of this range. Until
17 permanent local switching prices are established, using the TELRIC-based pricing
18 methodology, Sprint believes that applying the rate in the middle of the range is a
19 reasonable approach.

20

21 **III. Reciprocal Compensation Arrangements**

22 **(A) Summary of Position**

1 Q. Has GTE submitted a cost study for transport and termination under reciprocal
2 compensation arrangements which complies with the act and the FCC's order?

3

4 A. No.

5

6 Q. What does the act require for the pricing of transport and termination under
7 reciprocal compensation arrangements?

8

9 A. Section 251(b)(5) of the Act requires all LECs to "establish reciprocal compensation
10 arrangements for the transport and termination of telecommunications." Section
11 252(d)(2)(A) of the Act sets forth two standards for determining if reciprocal
12 compensation rates are just and reasonable. The first standard is that, "such terms and
13 conditions provide for the mutual and reciprocal recovery by each carrier of costs
14 associated with the transport and termination on each carrier's network facilities of calls
15 that originate on the network facilities of the other carrier." The second standard is that
16 it is necessary to "...determine such costs on the basis of a reasonable approximation of
17 the additional costs of terminating such calls." Section 251(d)(2)(B)(i) of the Act states
18 the rules do not "preclude arrangements that afford the mutual recovery of costs through
19 the offsetting of reciprocal obligations, including arrangements that waive mutual
20 recovery (such as bill-and-keep arrangements)." Section 251(d)(2)(B)(ii) of the Act
21 states that the Act does not "authorize the Commission or any State commission to
22 engage in any rate regulation proceeding to establish with particularity the additional
23 costs of transporting and terminating calls." Additionally, section 251(g) makes clear

1 that Congress intended access charges to remain in effect, separate from the transport
2 and termination of local traffic under reciprocal compensation arrangements.

3
4 **Q. What does the FCC order require for the pricing of reciprocal compensation?**

5
6 **A.** The pricing and application of transport and termination under reciprocal compensation
7 arrangements requires two considerations, first, establishing the correct cost-based
8 prices; and second, establishing a definition of local traffic to which the prices are
9 applied.

10
11 (1) Pricing

12 The FCC defined the "additional cost" standard discussed in section 252(d)(2)(A)(ii) of
13 the Act to be "the forward-looking, economic cost-based pricing standard that we are
14 establishing for interconnection and unbundled elements." Specifically, "additional cost"
15 is equal to TELRIC plus a reasonable allocation of forward-looking joint and common
16 costs.

17
18 (2) Definition of Local Traffic

19 Regarding the definition of local traffic, the FCC declared that "state commissions have
20 the authority to determine what geographic areas should be considered "local areas" for
21 the purpose of applying reciprocal compensation obligations under section 251(b)(5),..."

22
23 (3) Other Considerations

1 The FCC also defined transport and termination which was necessary for correctly
2 pricing each service. Transport was defined as "the transmission of terminating traffic
3 that is subject to section 251(b)(5) from the interconnection point between the two
4 carriers to the terminating carrier's end office switch that directly serves the called
5 party..." Additionally, the FCC defined termination as "the switching of traffic that is
6 subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent
7 facility) and delivery of that traffic from that switch to the called party's premises."

8
9 **Q. What is Sprint's position regarding the pricing of reciprocal compensation?**

10
11 **A.** Rates for transport and termination under reciprocal compensation arrangements should
12 be based on the TELRIC-based pricing methodology as discussed previously in my
13 testimony. In the interim period, until such rates are set, the commission should
14 implement bill-and-keep.

15
16 **(B) Developing Cost-Based Rates**

17 **Q. What options does the FCC order put forth for quickly establishing rates for**
18 **transport and termination?**

19
20 **A.** The FCC found that a state commission has three options for establishing transport and
21 termination rates under reciprocal compensation. First, a state commission may
22 conduct a through review of economic studies prepared using the same TELRIC-based

1 methodology that is used for pricing unbundled elements. Second, a state may adopt
2 the FCC's default proxy price of 0.2¢ per MOU to 0.4¢ per MOU for termination and a
3 default proxy price for transport rates based on tariffed interstate rates. Third, a state
4 may order "bill and keep."

5
6 **Q. Which option should the commission choose?**

7
8 **A.** The FCC stated that the only permanent solution is for state commissions to conduct a
9 through review of economic studies prepared using TELRIC-based cost methodology.
10 Bill-and-keep and the FCC's default proxy prices were established only as interim
11 solutions to allow states to quickly establish interim rates in order promote the Act's goal
12 of quickly permitting competitors into the local market.

13
14 **Q. What does the FCC order require for establishing the cost-basis of transport and
15 termination?**

16
17 **A.** Termination (end office switching) should be based on TELRIC plus a reasonable
18 allocation of forward-looking common costs. A full discussion of the correct
19 methodology for calculating TELRIC and forward-looking joint and common costs is
20 found in section I of this testimony.

21
22 Tandem switching should also be based on TELRIC plus a reasonable allocation of
23 forward-looking common costs.

1
2 Interim transport should be based on existing tariffs. For transport, the FCC stated that
3 the established price proxies for unbundled transport elements should be used.
4 Specifically, common transport should be priced at the weighted average per minute
5 equivalent of the dedicated transport rate as described in FCC 51.513(c)(4). Dedicated
6 transport should be priced based on tariffed interstate rates.

7
8 Regarding lost revenues from other services, the FCC specifically noted that "the rates
9 for the transport and termination of traffic shall not include an element that allows ILECs
10 to recover any lost contribution to basic, local service rates represented by the
11 interconnecting carriers' service."

12
13 **Q. Doesn't section 251(d)(2)(b)(ii) of the Act prohibit a state commission from**
14 **ordering a LEC to submit cost studies to establish the price of transporting and**
15 **terminating calls?**

16
17 **A.** No. The FCC found that Section 251(d)(2)(B)(ii) of the Act does not preclude state
18 commissions from conducting an investigation of forward-looking TELRIC cost studies.
19 The FCC differentiated such studies from the traditional rate base, rate-of-return studies
20 that the FCC believes Congress intended to preclude in Section 251(d)(2)(B)(ii) of the
21 Act.

22
23 **Q. Why is it important for TELRIC-based rates to be correctly established?**

1

2 A. It is crucial that the commission set the price of transport and termination under
3 reciprocal compensation at economic cost. As the FCC noted in their order, call
4 termination is an essential element in completing calls because competitors are required
5 to use the ILEC's existing networks to terminate calls to the ILEC's customers. Hence,
6 the ILEC has a great incentive and opportunity to charge terminating prices in excess of
7 economically efficient levels (see FCC Order par 1058). To ensure that rates for
8 reciprocal compensation foster economically efficient competitive entry, termination
9 rates should be priced at TELRIC plus a reasonable allocation of forward-looking
10 common costs.

11

12 (C) Definition of Local Traffic

13 Q. How does the FCC order define local traffic?

14

15 A. The FCC concluded that "section 251(b)(5) reciprocal compensation obligations should
16 apply only to traffic that originates and terminates within a local area..." Conversely,
17 access rates should apply to traffic that originates from or terminates to an area outside
18 of the local area. The FCC went on to declare that "state commissions have the
19 authority to determine what geographic areas should be considered "local areas" for the
20 purpose of applying reciprocal compensation obligations under section 251(b)(5)..."
21 While some discussion was given to the inclusion of expanded local area calling plans

1 into the definition of local calling areas, the FCC lacked sufficient record information to
2 address the issue.

3
4 **Q. How should local traffic be defined for the purposes of reciprocal compensation?**

5
6 A. Local calling areas should be defined to include the largest flat-rated optional calling
7 plan area the LEC offers as well as extended area service (EAS) routes. The inclusion
8 of expanded local area calling plans such as EAS and mandatory wide area calling
9 plans into the definition of local calling areas will foster full and fair competition,
10 especially as competing carriers vertically integrate to provide local and toll traffic. It is
11 critical for the state commission to define local calling areas the same for the ILEC and
12 its competitors. Defining non-mirroring local calling will create an unlevel playing field
13 and arbitrarily advantage one competitor over another.

14
15 **Q. How can non-mirroring local calling areas create an unlevel playing field and
16 arbitrarily advantage one competitor over another?**

17
18 A. Presently, access is priced several times higher than reciprocal compensation. If a
19 competitor can have its traffic rated as reciprocal compensation rather than access, that
20 competitor will have an enormous cost advantage. The ILEC can take advantage of the
21 distinction between access and reciprocal compensation and define their traffic as local
22 traffic based on their expanded local area calling plans

23

1 Q. Even if the ILEC and the CLEC have the same local calling areas won't the wide
2 disparity between rates for reciprocal compensation and access cause similar
3 problems?
4

5 A. While existing non-local access was not addressed by the FCC Order, it is important to
6 note that both the FCC and Congress (see section 251(g)) observed that the rates for
7 access and the rates for transporting and terminating local traffic will ultimately converge
8 since they provide the same identical network functions. Such a convergence is
9 inevitable and essential. In a competitive environment, it is nearly impossible to
10 maintain arbitrary pricing distinctions for identical services. Any attempt to maintain
11 such artificial distinctions leads to the very real probability that carriers will seek
12 opportunities to arbitrage and have their access traffic rated under the less expensive
13 reciprocal compensation rates. Such gaming leads to competition, not based on which
14 competitors operate most efficiently, but based on which competitors can get their
15 access traffic rated under reciprocal compensation. This is of particular concern now
16 that GTE has been allowed into the in-region long distance market. If an arbitrary
17 pricing distinction remains between access and reciprocal compensation, GTE will only
18 incur their economic cost for access, while its competitors pay inflated access charges.
19 Artificial pricing distinctions create an uneven playing field and stifle the development of
20 true competition.
21

22 **(D) Other Pricing Issues - Proxy Prices, Symmetry, and Bill-and-Keep**

1 Q. **When is it appropriate for a commission to adopt the FCC's proxy rates?**

2

3 A. A state should adopt the FCC proxy rates if it has not set rates consistent with the
4 FCC's default price ceilings and ranges nor reviewed or conducted TELRIC cost studies.

5

6 Q. **What is the proxy price recommended by the FCC?**

7

8 A. For transport, the FCC stated that the established price proxies for unbundled transport
9 elements should be used. Specifically, common transport should be priced at the
10 weighted average per minute equivalent of the dedicated transport rate as described in
11 FCC 51.513(c)(4). Dedicated transport should be priced based on tariffed interstate
12 rates. Termination (end office switching) should be priced within the 0.2¢ - 0.4¢ proxy
13 range. Tandem switching should be priced at the proxy of 0.15¢ per minute of use. The
14 FCC recommended default proxy prices only as an interim price until the state can
15 conduct or review a forward-looking cost study and develop state-specific transport and
16 termination rates. Use of the proxy is intended to promote the Act's goal of rapid
17 competition in the local exchange.

18

19 Q. **Are symmetrical rates appropriate?**

20

21 A. Yes. In answering the question of whether transport and termination charges should be
22 symmetrical the FCC concluded that, "it is reasonable to adopt the incumbent LEC's

1 transport and termination prices as a presumptive proxy for other telecommunications
2 carriers' additional costs of transport and termination *

3
4 **Q. Is it appropriate for the Commission to order bill-and-keep on an interim basis?**

5
6 A. Yes. The argument in favor of symmetry extends into bill-and-keep. Specifically, the
7 FCC concluded that "state commissions may impose bill-and-keep arrangements if
8 neither carrier has rebutted the presumption of symmetrical rates and if the volume of
9 termination traffic that originates on one network and terminates on another network is
10 approximately equal to the volume of terminating traffic flowing in the opposite direction,
11 and is expected to remain so, ...". Absent traffic studies of the flow of local traffic
12 between an ILEC and a CLEC or approved cost studies, it is reasonable to utilize bill-
13 and-keep.

14
15 **Q. Why should the Commission quickly establish interim rates for reciprocal
16 compensation?**

17
18 A. It is important for rates to be established as quickly as possible to begin the
19 development of competition and start offering the benefits of such competition to end
20 users. In an effort to quickly allow competition to begin to develop, Sprint recommends
21 that the Commission implement bill-and-keep (or the proxy rates where measurement
22 capabilities exist) for an interim period while the Commission conducts economic cost
23 studies to determine the appropriate rate. Delays in allowing competing CLECs to

1 interconnect their networks to the ILECs and terminate their traffic on the ILECs'
 2 networks is one of the biggest threats to the development of local competition. The
 3 Commission should act swiftly to allow the CLECs to interconnect their networks by
 4 requiring bill-and-keep (or proxies) for the interim period. Such a policy will bring the
 5 benefits of local competition to customers in as quick a manner as possible without
 6 causing undue harm to the interconnecting carriers. Allowing local competition to begin
 7 immediately under an interim arrangement will quickly foster the development of
 8 competition while still giving the Commission time to deliberate on the proper cost basis
 9 for a more permanent rate under reciprocal compensation

10

11 **Q. Please summarize your recommendations for the commission**

12

13 A. In the early stages of competition, where the ILECs move from controlling 100% of local
 14 traffic to a competitive market, it is critical for the commission to set the rules for the
 15 transport and termination of local traffic under reciprocal compensation such that they
 16 promote the development of competition. This requires a number of factors as
 17 discussed above. First, for the purpose of reciprocal compensation, the Commission
 18 should define local calling areas the same for GTE and its competitors. The inclusion of
 19 expanded local area calling plans such as extended area service (EAS) and mandatory
 20 wide area calling plans into the definition of local calling areas will foster full and fair
 21 competition, especially as competing carriers vertically integrate to provide local and toll
 22 traffic. Second, it is important for rates to be established as quickly as possible to begin
 23 the development of competition. In an effort to quickly allow competition to begin to

1 develop, Sprint recommends that the Commission implement interim bill-and-keep or
2 proxies where a measurement process is established while the Commission conducts
3 cost studies to determine the appropriate rate. And third, it is crucial that the
4 commission set the price of transport and termination under reciprocal compensation at
5 economic cost, i.e. the TELRIC-based pricing methodology. Setting prices at this level
6 will foster and ensure the development of full and fair competition. These steps, taken
7 together, will foster the growth of local competition and ensure that end user customers
8 enjoy those benefits.

10 **IV. Wholesale Pricing for Resale**

11 **(A) Summary of Position**

12 **Q. Has GTE provided avoided cost studies that satisfy the requirements of the Act**
13 **and the FCC Order?**

14
15 **A. No.**

16
17 **Q. What does the Act require for the pricing of wholesale services?**

18
19 **A. Section 252(d)(3) states that wholesale rates should be determined "on the basis of**
20 **retail rates charged to subscribers for the telecommunications service requested,**
21 **excluding the portion thereof attributable to any marketing, billing, collection, and other**
22 **costs that will be avoided by the local exchange carrier."**

1

2 **Q What does the FCC Order require for the pricing of wholesale services?**

3

4 A. The FCC found that the 1996 Act required states to make an assessment of what costs
5 are reasonably avoidable when a LEC sells its services wholesale. Specifically, the
6 FCC rejected the LEC's arguments that operating expenses must actually be reduced to
7 be considered "avoided" for purposes of section 252(d)(3) and concluded that an
8 avoided cost study must include indirect, or shared, costs as well as direct costs.

9

10 **Q. What is Sprint's position regarding the pricing of wholesale services?**

11

12 A. Wholesale rates should be based on the retail rates charged to subscribers for the
13 telecommunications service requested less all avoidable costs. Avoidable costs include
14 the direct marketing, billing, collection, and other costs that are not incurred when an
15 ILEC sells a service at wholesale, plus an allocation of the general support expenses,
16 corporate operations expenses, and uncollectibles. Rather than offering just one overall
17 discount rate, ILECs should offer a specific wholesale discount rate for at least five
18 separate categories of service to more accurately reflect the different underlying
19 avoidable costs inherent in the five categories. The five categories are simple access
20 (R1, B1, and local usage), complex access (Centrex, Key, and PBX), features (CCF,
21 CLASS, and Centrex features), Operator/DA, and Other (private line, intraLATA toll,
22 etc.).

23

1 **(B) Avoided Cost Study - Methodology**

2 **Q. Please describe the Avoided Cost Study methodology required by the FCC Order.**

3

4 **A.** The FCC specifically identified 20 (Uniform System of Accounts) USOA cost accounts
5 that contain avoidable costs. All⁹ costs recorded in accounts 6611 - product
6 management; 6612 - sales; 6613 - product advertising, and 6623 - customer services
7 are the direct costs of serving customers and are presumed to be avoidable. Accounts
8 6621 - call completion services and 6622 - number services are avoidable costs
9 because resellers will provide these services themselves or contract for them separately
10 from the LEC or from third parties

11

12 The costs contained in accounts 6121-6124 - general support expenses; 6711, 6612,
13 6721-6728 - corporate operations expenses; and 5301 - telecommunications
14 uncollectibles are avoidable in proportion to the avoided direct expense identified in
15 accounts 6611-6613 and 6621-6623 because wholesale operations will reduce general
16 overhead activities such as customer inquiries, billing and collection, etc..

17

18 **Q. Why is it reasonable to include general overhead expenses in an avoided cost**
19 **study as recommended by the FCC?**

20

⁹ The FCC Order actually applied a factor of 90% to these accounts in determining the default range in order to recognize that some of these costs are not avoided by selling services at wholesale FCC Order at paragraph 928

1 A. As a LEC provides fewer retail services and more wholesale services, it is reasonable to
2 expect that the LEC can avoid the general and administrative overhead and general
3 support costs that are currently used to support the LEC's enormous retail operations
4 today. In paragraph 912 of the FCC's 06-98 Order, the FCC stated

5
6 " ...the overall level of indirect expenses can reasonably be expected to decrease
7 as a result of a lower level of overall operations resulting from a reduction in retail
8 activity "

9
10 This point can best be illustrated with the following example. Suppose the LEC's retail
11 business decreased to zero and the LEC became solely a wholesale supplier of local
12 services. In that scenario, the LEC would not need any retail customer service
13 representatives. This, in turn, would mean that the LEC would not need the land and
14 buildings that housed those representatives, the computers they used, nor the
15 information support services people that supported those computers, nor the office
16 equipment they used, the accounting personnel to pay them, nor the human resources
17 personnel to hire and train them, etc. The list goes on to include each function and
18 service the LEC currently supplies to its retail customer service representative
19 employees. Thus, it follows, that as the size of the LEC's retail business decreases, so
20 should the accompanying overhead is avoided. As the need for such overhead
21 decreases, it is inevitable that the LEC would seek to reduce its overhead to capture
22 those cost savings. Hence, it is reasonable and necessary to allocate a portion of those

1 current overhead expenses to the directly avoidable costs as recommended by the
2 FCC.

4 (C) Wholesale Rate Categories

5 **Q. For how many categories of service should discount rates be determined?**

6
7 **A.** Ideally, an avoided cost study should be conducted for each individual retail service an
8 ILEC provides. However, neither the Commission nor any company has the time or
9 resources to conduct such a monumental number of studies and debate them before the
10 Commission. Thus, it makes sense to combine a number of services and conduct a
11 limited number of cost studies. The debate rests on the appropriate number of service
12 categories. In their order, the FCC acknowledged that while a uniform discount rate is
13 simple to apply, avoided costs may vary among services. The FCC concluded that
14 states may choose to approve nonuniform wholesale discount rates based on an
15 avoided cost study for a number of different service groups.

16
17 **Q. How many categories of service do you recommend?**

18
19 **A.** Rather than offering just one uniform discount rate, I recommend that GTE should offer
20 a specific wholesale discount rate for at least five separate categories of service to more
21 accurately reflect the different underlying avoided costs inherent in the five categories.
22 The minimum five categories are simple access (R1, B1, and local usage), complex

1 access (Centrex, Key, and PBX), features (CCF, CLASS, and Centrex features),
2 Operator/DA, and Other (private line, intraLATA toll, etc)

3
4 **Q. What is the benefit of using at least five categories of service rather than just**
5 **one?**

6
7 Five separate categories of service would more accurately reflect the different
8 underlying avoided costs inherent in the categories. While some parties may argue for
9 only one or two categories of service, such a limited number does not accurately set an
10 appropriate discount rate for some of the services contained within those categories.
11 That is because the bulk of an ILEC's revenue resides in local access services such as
12 R1, B1, local usage, Centrex, Key, and PBX. These services have vastly different
13 avoided costs than do operator/DA services, custom calling features, and other
14 services. If all of these services are lumped into one avoided cost study, the large local
15 access service categories skew the study towards the discount rate appropriate only for
16 itself. The end result is that a single overall discount rate will mean that custom calling
17 features are not discounted enough and that operator/DA services are discounted too
18 much. Such an imbalance in discount rates will create an unlevel playing field and may
19 competitively harm some of the entrants.

1 **(D) Benefits of Correctly Determining Wholesale Rates**

2 **Q. What benefits accrue if wholesale rates are based on correctly calculated avoided**
3 **cost studies?**

4
5 A. Correctly determining wholesale rates will place resellers on a more equal footing with
6 the ILECs and allow them to more fairly compete with the ILECs. With both the ILEC
7 and the CLEC using wholesale rates as the cost basis for their service, they are forced
8 to compete for customers by efficiently marketing their services and reducing their
9 general overheads. Such competition will force the ILECs to operate on a much more
10 efficient basis and lead to lower rates for all services for end users, whether they
11 purchase their service from the ILEC or the CLEC

12
13 **Q. What harm will occur if wholesale rates are priced higher than they should be?**

14
15 A. To set wholesale rates at a level that does not remove all of the avoided costs, gives the
16 ILECs an anticompetitive advantage over resellers. ILECs can use the additional
17 revenue to under price resellers, operate less efficiently, or cross-subsidize other
18 services. Correctly set wholesale prices will spur the development of resale competition
19 which will lead to better choices and prices for customers and foster the development of
20 facilities-based competition

21

1 Q. **What other benefits accrue if wholesale rates are based on the FCC's avoided**
2 **cost study methodology?**

3

4 A. The FCC clearly identified the appropriate USOA accounts to be used in calculating
5 avoidable costs. The guidelines were designed to foster consistent interpretations of the
6 1996 Act in setting wholesale rates based on avoided cost studies with the hope that
7 such consistency would facilitate swift entry by national and regional resellers

8

9 Q. **Will wholesale rates fairly compensate the ILECs?**

10

11 A. Wholesale rates will fairly compensate ILECs for wholesale services just as fully as retail
12 rates compensate them for retail services. The result is competitively neutral
13 Avoidable costs are those costs the ILEC does not incur when they sell the service on a
14 wholesale basis. These costs fall into three categories (1) the direct costs of serving
15 retail customers of those specific services that are avoided when the service is sold on a
16 wholesale basis; (2) costs avoided because resellers will provide for these retail
17 activities themselves or contract for them separately from the ILEC or a third party, and
18 (3) the ILEC's overhead costs which should proportionally decrease as the ILEC's retail
19 business decreases.

20

21

22

1 (E) Proxy Wholesale Rates

2 Q. When is it appropriate to use a proxy default rate?

3
4 A. In general, the FCC's proxies are to be used only in the interim period while appropriate
5 avoided cost studies are being conducted. The FCC identified three situations when it
6 would be appropriate to use of their proxy default rates: one, in a state arbitration
7 proceeding if an avoided cost study that satisfies the FCC's avoided cost criteria does
8 not exist; two, where a state has not completed its review of the ILEC's avoided cost
9 study; and three, where a rate was established by a state before the release date of the
10 FCC's Order and is based on a study that does not comply with the FCC's avoided cost
11 study criteria.

12
13 Q. What is the appropriate default wholesale discount rate?

14
15 A. The FCC set a default proxy range of 17% to 25% that is to be used in the absence of
16 an avoided cost study that meets the criteria set forth by the FCC. While the FCC
17 calculated a proxy wholesale discount rate specific to GTE of 18.81%, the FCC noted
18 that a state may choose a discount rate from anywhere within the 17% to 25% range,
19 but should articulate the reasons for their selection of a particular discount rate

20
21 (Note: Paragraph 930 of the Order sets forth the following discount rates)
22

1	US West	18.80%
2	GTE	18.81%
3	BellSouth	19.20%
4	Bell Atlantic	19.99%
5	SBC	20.11%
6	NYNEX	21.31%
7	Pacific	23.87%
8	Ameritech	25.98%

9

10 V. Parity Pricing Issues

11 (A) Volume Discounts

12

13 Q. What Act requirements are related to the issue of volume discounts?

14

15 A. The Act: 1) requires interconnection on rates, terms, and conditions that are just,
16 reasonable, and *nondiscriminatory* (251(c)(2)(D)); 2) requires *nondiscriminatory* access
17 to network elements (251(c)(3)) and 3) *prohibits discriminatory* resale conditions
18 (251(c)(4)(B)).

19

20 Q. Are there requirements in the FCC Order related to the issue of volume
21 discounts?

22

1 A. Yes. The FCC found that the term "nondiscriminatory", as used throughout section 251
2 of the Act, applies to the terms and conditions an incumbent LEC imposes on third
3 parties as well as itself and that by providing interconnection to a competitor in a manner
4 less efficient than an incumbent LEC provides itself, the incumbent LEC violates the
5 duty to be "just" and "reasonable" under section 251(c)(2)(D) (paragraph 218). With
6 respect to volume pricing, the FCC indicated that volume discounts should correspond
7 to cost differences of selling in large volumes. Specifically, the FCC noted that in
8 calculating the proper wholesale rate, incumbent LECs may prove that their avoided
9 costs differ when selling in large volumes (paragraph 953).

10

11 **Q. What is Sprint's position regarding volume discounts?**

12

13 A. Sprint believes that volume discounts that are not based on cost differences of providing
14 the service at the specified volume are not consistent with the cost-based principles
15 contained in the Act and the FCC Order and are discriminatory and contrary to the
16 public interest. Any volume discount in interconnection and resale prices must be cost-
17 justified or prohibited.

18

19 **Q. Why are non-cost based term and volume discounts discriminatory?**

20

21 A. Such discounts advantage larger CLECs to the detriment of smaller CLECs. The term
22 "nondiscriminatory" is used throughout Section 251 of the Act because Congress
23 intended to create an environment where any reasonably efficient provider has the

1 opportunity to compete. Non-cost based discounts discriminate in favor of only the
2 largest providers that can take advantage of the discount, without regard to whether the
3 party receiving the discount is actually the most efficient provider
4

5 **Q. Why are non-cost based volume discounts contrary to the public interest?**

6
7 A. Discounts that are not proportionate to the amount of cost actually saved create an
8 environment where size, rather than economic efficiency, becomes the key determinant
9 of marketplace success. The outcome from the public's perspective is a diminishment
10 in the number of choices available and the exclusion of potentially more-efficient
11 providers from the market. For example, suppose a CLEC purchasing 100,000
12 individual loops receives a per loop price that is 50% less than two CLECs each
13 purchasing 50,000 of the exact same 100,000 loops, the first CLEC has a sizable
14 advantage over the other CLECs merely because of its size, not because it is any more
15 efficient than the other CLECs. Whether the underlying provider sells the 100,000 loops
16 to the first CLEC or to the other two CLECs separately there is little, if any, difference in
17 the underlying provider's cost. Yet, although the first CLEC has not introduced any
18 efficiencies, it has the opportunity to drive the smaller CLECs out of the market. Unless
19 volume discounts are tied directly to actual cost differences, smaller, more efficient
20 CLECs may be driven out of the market to the detriment of the public interest
21

22 **Q. What is GTE's stated position on volume discounts?**

1

2 A. While GTE did not specifically respond to the Sprint Term Sheet item 1 C, as updated to
3 reflect the FCC Order, GTE's previously stated position was that it "will discuss volume
4 discounts with Sprint, but desires to provide volume discounts to our customers."

5

6 **(B) Non-Recurring Charges**

7 **Q. What is Sprint's position regarding the application of non-recurring charges on**
8 **ILEC initiated network and system activities?**

9

10 A. The term sheet Sprint has used in negotiations states that "ILEC will not charge Sprint
11 any non-recurring charges incurred as a result of ILEC implementing network
12 redesigns/reconfigurations or electronic system redesign/reconfigurations initiated by the
13 ILEC to its own network or systems. However, any redesign or reconfiguration
14 expenses required by a regulatory body where the regulatory body establishes a cost-
15 sharing arrangement may be billed on an appropriate non-discriminatory basis to
16 Sprint."

17

18 **Q. What should Sprint's position be adopted?**

19

20 A. Sprint's position represents a reasonable approach to non-recurring cost recovery
21 related to network changes and electronic system changes. Essentially, Sprint simply
22 maintains that any network or systems changes that are initiated by GTE and are not

1 performed solely on Sprint's behalf should not be charged to Sprint. It is reasonable for
2 Sprint to maintain that it is only willing to provide such non-recurring cost compensation
3 if the compensation is ordered by a regulatory body in a competitively neutral manner,
4 i.e. where costs are shared by all beneficiaries of the network or system change.
5 Beneficiaries of such changes likely include all interconnectors and GTE since these
6 network and system changes should only be performed to enhance business
7 transaction efficiencies of both the ILEC and the CLEC and the efficient interoperability
8 of both the ILEC and CLEC networks.

9
10 Q. What is GTE's position on this issue?

11
12 A. GTE did not comment one way or another on this issue. Sprint takes GTE's non-
13 opposition as concurrence. If GTE does oppose Sprint's position, Sprint is not aware of that
14 fact.

15
16 **(C) Interim Number Portability**

17 Q. **What is Sprint's position regarding the pricing of interim number portability?**

18
19 A. The term sheet Sprint has used in negotiations states "Sprint and the ILEC will establish
20 reasonable cost recovery for RCF/DID. Existing retail call forwarding rates are not
21 considered reasonable for this purpose. Sprint proposes that interim number portability
22 be priced at TELRIC cost less a 55% discount which recognizes that interim number

1 portability solutions degrade network performance to Sprint's customers. Should a
2 lower interim number portability price be offered by ILEC to others or ordered by a
3 regulatory body, Sprint may adopt the lower price."

4
5 **Q. What is GTE's position to these terms?**

6
7 A. GTE has not specifically responded to this term sheet item. Earlier, however, GTE
8 stated that it would provide local number portability via remote call forwarding where
9 technically feasible based on state requirements. GTE provided no assurance that it
10 would do anything but offer remote call forwarding as currently tariffed at the state level.

11
12 **Q. Why should Sprint's position be adopted?**

13
14 A. Sprint's proposal provides a reasonable, competitively-neutral approach to
15 compensation for interim number portability. RCF and DID as interim number portability
16 solutions are inferior to the permanent database solution being developed by the
17 industry. Sprint's proposal of a 55% discount is based on the discount that the FCC
18 required for inferior long distance access.¹⁰ Sprint believes that this precedent provides
19 a reasonable level of discount for the inferiority of interim number portability solutions.

20

¹⁰ FCC Access Charge Rules, 47 C.F.R. § 69.105.

1 The intent of the Act is to set up competitive markets. Competition will be at best
2 slowed or ineffective if the ILEC is allowed to provide competitors with inferior
3 interconnection solutions and then to also charge premium prices to these competitors.
4 The inferior technical qualities would force competitors' services to be of lower quality
5 than the ILECs' services. The premium prices would cause the competitors to incur
6 costs that are equal to or greater than the ILECs' costs. This would limit the
7 competitors' abilities to offer lower prices that would compensate customers for the
8 lower service quality. Also, this discount is consistent with the Section 252(d)(1) of the
9 Act which requires that prices be just, reasonable, cost-based, and nondiscriminatory.
10 The discount is just, reasonable, and nondiscriminatory because it places the ILEC and
11 the other carriers on comparable competitive footing.

12 13 **(D) Application of Cost-Based Pricing - Miscellaneous**

14 **Q. What is Sprint's position regarding compensation for engineering surveys?**

15
16 **A.** With respect to fees for engineering surveys, the term sheet states that "Fees related to
17 engineering surveys for potential right-of-way use shall be based on TELRIC plus a
18 reasonable allocation of joint and common costs and be consistent with the provisions of
19 the Act.

20
21 **Q. What is GTE's position?**

22

1 A GTE has not responded to this Sprint Term Sheet item since Sprint's update to reflect
2 the FCC Order, however, GTE's prior statement was that "the costs for make ready,
3 rearrangement, or expansion of capacity will be paid by the company requesting the
4 attachment that creates the need. If several parties want new attachments on the same
5 facilities at the same time, they can approach GTE and we will split the costs between
6 those parties."

7

8 **Q. Why should Sprint's position be adopted?**

9

10 A Sprint believes that the TELRIC-based pricing methodology is a reasonable means of
11 compensation for these engineering survey costs because it represents the economic
12 cost of providing this activity. Without this standard GTE may impose charges not
13 reflective of the underlying cost of these activities to the detriment of Sprint.

14

15 **Q. What is Sprint's position regarding compensation for PIC administration?**

16

17 A. With respect to PIC administration change charges, the term sheet states that "Any PIC
18 administration change charge must be at TELRIC plus a reasonable allocation of
19 forward-looking joint and common costs."

20

21 **Q. What is GTE's position?**

22

1 A GTE did not specifically respond to this term sheet item. Based on GTE's general
2 reluctance to accept Sprint's position on limiting joint and common costs in developing
3 TELRIC-based prices, Sprint concludes that GTE disagrees.

4
5 **Q. Why should Sprint's position be adopted?**

6
7 A PIC administration changes are a necessary input to Sprint's business and Sprint is
8 entirely dependent upon the ILEC as switch provider for this activity. Application of the
9 TELRIC-based pricing methodology is a reasonable approach in establishing these
10 charges and is completely consistent with the methodology applied to interconnection
11 and unbundled network elements.

12
13 **Q. Does this conclude your testimony?**

14
15 A Yes it does.

1 **Q. Please state your full name, position, and business address.**

2 A My name is David E. Stahly. I am employed by Sprint Communications Company
3 Limited Partnership (Sprint) as a Manager of Regulatory Policy. My business
4 address is 8140 Ward Parkway, Kansas City, Missouri 64114.

5
6 **Q. Are you the same David Stahly that previously filed direct testimony in this
7 proceeding?**

8 A Yes.

9
10 **Q. What is the purpose of your testimony?**

11 A The purpose of my testimony is to outline Sprint's proposal for interim rates
12 for interconnection and to comment on GTE's cost study, in rebuttal to
13 GTE's response to Sprint's petition for arbitration. Regarding GTE's cost
14 study, I will comment on GTE's position on cost and pricing issues as
15 reflected in the direct testimony of GTE witness Michael J. Doane and
16 clarify Sprint's position as it relates to pricing of wholesale services.

17
18 **I. SPRINT'S POSITION**

19 **Q. What is Sprint's position regarding GTE's cost studies?**

20 A GTE has failed to show that their proposed prices are just and
21 reasonable. Although GTE has submitted reams of paper, their costing
22 and pricing methodologies are based on assumptions that inconsistent
23 with the principles of the Federal Telecommunications Act of 1996 and
24 the FCC's Order in 96-98 which render the resultant prices meaningless.

1 GTE's cost studies and prices should be rejected and other prices used
2 in their place.

3
4 **Q. If the Commission rejects GTE's cost studies, what does Sprint
5 propose for interim interconnection rates?**

6 A. Sprint is willing to accept, on an interim basis, all rates, terms, and
7 conditions that result from the outcome of the arbitration between AT&T
8 and GTE. This includes prices for unbundled network elements,
9 transport and termination under reciprocal compensation arrangements,
10 wholesale discounts, and all other services offered under such
11 interconnection agreements. In the event that the AT&T agreement is
12 revised by the Commission or a court on appeal, Sprint will abide by any
13 terms or conditions resulting from such appeal. However, in the event
14 such an appeal leads to the award of rates that are higher or discounts
15 that are lower than those awarded to AT&T in its arbitration, Sprint is
16 willing to give the new rates retroactive affect only if the Commission or
17 Court issuing the appeal order requires AT&T also to apply the new rates
18 retroactively.

19
20 **Q. Does the Federal Telecommunications Act support Sprint's
21 proposal to use the rates established in the AT&T arbitration?**

22 A. Yes. Section 252(i) of the Act states that
23


1 "A local exchange carrier shall make available any
 2 interconnection, service, or network element provided under an
 3 agreement approved under this section to which it is a party to
 4 any other requesting telecommunications carrier upon the same
 5 terms and conditions as those provided in the agreement."

6
 7 The Act clearly states that GTE is required to offer Sprint or any other
 8 telecommunications provider the same terms and conditions for any
 9 interconnection, service or network element that it offers AT&T. Sprint is
 10 willing to accept all of the prices arbitrated in ~~that~~ ^{GTE + AT&T} agreement on an
 11 interim basis.

12
 13 **Q. What does Sprint propose for permanent interconnection rates?**

14 A. To establish permanent rates, Sprint proposes opening a generic cost
 15 docket to review GTE's TELRIC, shared and common cost studies. In an
 16 effort to make the most efficient use of the Commission's time and
 17 resources, the docket should be open to all parties rather than conducted
 18 as separate similar investigations of GTE's cost studies. Such a docket
 19 should be scheduled to allow time for all parties to fully investigate and
 20 determine the correct rates for interconnection.

21
 22 **II. Rebuttal of Michael J. Doane**

23  Additionally, Section 251(c) of the Act requires that
 24 rates for interconnection and resale be nondiscriminatory. Inasmuch as the Commission has set GTE's rates for interconnection and wholesale rates in Dockets 96-0847-TP and 96-0980-TP, for AT&T and MCI it would be discriminatory to allow GTE to charge Sprint different rates for the exact same service.

1 **Q. Do you agree with Mr. Doane's impression of the intent of the**
2 **Telecommunications Act of 1996 ("Act")?**¹

3 A. Yes. Mr. Doane's response to the question accurately describes the
4 sweeping nature of the changes to the telecommunications market provided by
5 the Act. He also accurately states that the Act will provide for a new "pro-
6 competitive" framework for encouraging competition in all parts of the
7 telecommunications industry

8

9 **Q. Which "segments" of the telecommunications industry will see this**
10 **increased competition?**

11 A. The Act provides for competition in the local exchange and long distance
12 segments of the telecommunications industry. As GTE allows competitive local
13 exchange companies ("CLECs") to interconnect to its network and begins to offer
14 resold services and unbundled network elements, consumers in Florida will begin
15 to see the benefits of local exchange competition. The Act also removes
16 restrictions on GTE's participation in the interLATA long distance market and as
17 GTE moves out into the interLATA long distance segment, Florida will see
18 increased long distance competition.

19

20 **Q. Have you reviewed Mr. Doane's concerns on Sprint's pricing proposal?**

21 A. Yes. On page 7 of Mr. Doane's direct testimony he states that Sprint's
22 proposal "will not allow GTE to recover its forward-looking costs." He goes on to
23 say that "monumental" subsidies will flow from GTE to Sprint and that Sprint

¹ Doane Direct Testimony, Page 3.

1 would be a "free rider" on GTE's network. Since Mr. Doane has not quantified
2 that amount of "monumental" subsidies which Sprint would receive, it is unclear
3 the economic impact of his concerns.

4

5 **Q. Do you agree with Mr. Doane's criticism of Sprint's pricing proposal?**

6 A. No. Sprint is not attempting to obtain a "free ride" on GTE's network. It is
7 Sprint's position that prices for unbundled elements should be based on the total
8 element long run incremental cost ("TELRIC") of providing the element plus a
9 reasonable allocation of common costs. An appropriately developed GTE
10 TELRIC cost study will identify all direct costs caused by Sprint's use of GTE's
11 network elements. These direct costs will include the incremental cost of
12 facilities and operations dedicated to the network element as well as the
13 incremental cost of shared facilities and operations. These shared facilities and
14 operations are interpreted by Sprint to mean "joint costs". It is obvious that
15 Sprint desires to pay for all costs which it directly causes on GTE's network.

16

17 **Q. Do you agree with Mr. Doane's specific concern with Sprint's**
18 **pricing proposal related to the handling of common costs?**

19 A. No. On page 8 of his testimony, he criticizes the use of a uniform markup
20 above TELRIC as arbitrary. He states that markups should be "market-based" in
21 response to competition. Uniform markups are not arbitrary, to the contrary they
22 are the fairest method for GTE to use to recover its common costs. GTE, at
23 least for some time to come, is essentially monopoly provider of network
24 elements. While some very limited competition does exist, e.g., competitive

1 access providers (CAPs), GTE should be expected to have virtually 100% of the
2 unbundled network market. Since common costs, by definition, do not vary
3 based on the number of unbundled elements offered, then establishing different
4 markups for differing unbundled elements in a non-competitive market would
5 simply be arbitrary.

6

7 **Q. Does Mr. Doane mischaracterize Sprint's positions as it relates to**
8 **wholesale pricing?**

9 A. Yes. Again, Mr. Doane accuses Sprint of wishing to "freeride" on GTE's
10 network by mischaracterizing its positions as it relates to wholesale pricing²
11 Appropriately developed avoidable cost studies will isolate those costs which will
12 go way when GTE provides wholesale services. An appropriately developed
13 avoidable cost study will not create "excessive discounts" as described by Mr.
14 Doane, but will accurately reflect the cost avoidance GTE should realize as an
15 efficient firm.

16

17 **Q. Mr. Doane states that Sprint is inconsistent in its argument for**
18 **uniform markups while calling for discounts by service category. Do you**
19 **agree?**

20 A. No. Apparently Mr. Doane does not understand the difference between a
21 uniform markup to recover common costs (costs which do not vary based on the
22 quantity of network elements) and avoidable costs discounts for wholesales
23 service categories. Markups to recover common costs should be uniform

² Doane Direct Testimony, Page 11

1 because no cost-causation can be established between the total amount of
2 common costs and an individual network element. Contrast this to Sprint's call
3 for wholesale service categorization. Wholesale services should be grouped
4 together since a cost-causation can be reasonably established between
5 categories of services.

6

7 **Q. Do you agree with Mr. Doane's M-ECPR pricing proposal found on**
8 **page 14 of his direct testimony?**

9 A No. Mr. Doane states that "[t]he M-ECPR price for an unbundled
10 network element is equal to the sum of its TELRIC plus its opportunity costs, as
11 constrained by market forces." He goes on to say that "[o]pportunity costs refers
12 to the net return that an unbundled network element will bring GTE if it is not sold
13 at wholesale to a competitor." Essentially Mr. Doane recommends that GTE be
14 allowed to price unbundled elements at existing retail rates. As an example, in
15 GTE witness Trimble's testimony, GTE recommends that loop prices be set
16 based on existing interstate 2-wire special access rates. In the case of loop
17 prices, allowing GTE to simply charge its special access rate for 2-wire service to
18 CLEC's removes the "cost-basis" for the rates. By simply charging the tariff rate,
19 it makes no difference what the incremental cost is since the TELRIC of the
20 unbundled loop has no effect on final rate charged to CLEC's (e.g., if the TELRIC
21 were lower the opportunity cost would simply be increased to get the price equal
22 to the tariffed rate). Additionally, Mr. Doane's M-ECPR pricing proposal ignores
23 the FCC's direction that, in keeping with the cost-based pricing standard of the
24 Act, rates for unbundled elements must be deaveraged.

1

2 **Q. Mr. Doane goes on to propose that a end-user charge should be**
3 **established. Do you agree?**

4 A. No. Absent in Mr. Doane's analysis is the reality that GTE is currently
5 moving into the interLATA long distance market. As described in my testimony
6 above, the Act is bringing competition to all segments of the telecommunications
7 industry - both local exchange and long distance. GTE is currently offering
8 interLATA services to its existing customers in many states. It is reasonable to
9 expect GTE to receive a sizable amount of additional revenues for this new line of
10 business. If GTE is concerned about losing revenues due to local exchange
11 competition, those revenues should be made up through their participation in the
12 interLATA long distance market.

13

14 **II. SPRINT'S POSITION ON PRICING OF WHOLESAL SERVICE**

15

16 **Q. Has Sprint petitioned with the Florida Public Utilities Commission**
17 **("Commission") for a generic docket on costing issues?**

18 A. Yes. Due to the importance and complexity of cost-related issues and
19 limited time-frames available to the Commission in this arbitration, Sprint has
20 petitioned the Commission to initiate a generic proceeding on rates of BellSouth
21 Telecommunications, Inc. for interconnection, unbundled elements, transport and
22 termination, and resale. As suggested in Sprint's petition for a generic cost
23 proceeding, Sprint does not believe that the Commission should attempt to
24 establish permanent rates at the current time. Instead it should adopt interim

1 rates With respect to the interim prices, Sprint requests that whatever prices
2 are ordered in the AT&T/GTE arbitration be adopted in this proceeding until
3 permanent rates are approved by the Commission
4

5 **III. RECOMMENDATIONS**
6

7 **Q. What does Sprint recommend that the Commission do at this time?**

8 A. To quickly establish interim rates, Sprint recommends that the
9 Commission order GTE to offer Sprint the same pricing agreement that
10 will result from the outcome of the arbitration between AT&T and GTE
11 This includes rates, terms, and conditions for unbundled network
12 elements, transport and termination under reciprocal compensation
13 arrangements, wholesale discounts, and all other services offered under
14 such interconnection agreements. Additionally, in the event that the
15 AT&T agreement is revised by the Commission or a court on appeal,
16 Sprint will abide by any terms or conditions resulting from such appeal.
17 However, in the event such an appeal leads to the award of rates that
18 are higher or discounts that are lower than those awarded to AT&T in its
19 arbitration, Sprint is willing to give the new rates retroactive affect only if
20 the Commission or Court issuing the appeal order requires AT&T also to
21 apply the new rates retroactively.
22

23 **Q. What does Sprint propose for permanent interconnection rates?**

1 A. To establish permanent rates, Sprint proposes opening a generic cost
2 docket to review GTE's TELRIC, shared and common cost studies. In an
3 effort to make the most efficient use of the Commission's time and
4 resources, the docket should be open to all parties rather than conducted
5 as separate similar investigations of GTE's cost studies. Such a docket
6 should be scheduled to allow time for all parties to fully investigate and
7 determine the correct rates for interconnection.

8

9 **Q. How does Sprint's proposal to adopt the AT&T agreement promote**
10 **competition?**

11 A. By allowing Sprint to operate under the same pricing structure as AT&T,
12 Sprint is placed on a level playing field with one of its larger competitors.
13 While GTE, Sprint's largest competitor for local service, still would retain
14 an enormous cost advantage over Sprint, at least Sprint would not be
15 disadvantaged relative to other new entrants.

16

17 **Q. What are the benefits to the Commission and the citizens of Florida**
18 **of adopting Sprint's proposal?**

19 A. Sprint's proposal quickly resolves the plethora of issues surrounding the
20 costing and pricing of all services that Sprint would seek to purchase from
21 GTE in order to operate as a CLEC in Florida. This saves the
22 Commission's resources allowing them to focus on other issues and
23 opens the door to promoting local competition in Indiana and providing
24 the citizens of Indiana with the benefits of competition for all

1 telecommunications services. The brief history of competition in the long
2 distance toll market clearly shows the benefits that accrue to customers.
3 Today, long distance customers enjoy dramatically lower toll rates,
4 discount calling plans that don't require customers to call at midnight, a
5 plethora of calling card and voice mail products, multilingual operators,
6 and other services too numerous to mention. I believe that competition
7 will bring the same product innovation and benefits to the local
8 telecommunications market.

9

10 **Q. Does this conclude your testimony?**

11 **A. Yes, it does.**

12

1 Q (By Mr. Fincher) Mr. Stahly, do you have a
2 summary of your testimony?

3 A Yes, I do. I would like to focus mostly on
4 my rebuttal testimony and limit my summary to what I
5 believe are the salient issues at this point.
6 Inasmuch as there is -- AT&T and MCI have already been
7 through the process with GTE, and the Commission has
8 already fully investigated GTE's cost studies and been
9 through that process, there's been, in essence, a
10 market price set. And it is Sprint's position what we
11 are asking for is simply to be availed of that market
12 price, to be able to get, as Mr. Hunsucker mentioned
13 earlier this morning, the same rates, terms and
14 conditions that are being offered to MCI and AT&T.

15 It may be pointed out that there are
16 differences in costing and pricing methodologies
17 between the different parties, between Sprint, between
18 GTE and AT&T. To the extent those differences exist,
19 from my point of view, it is irrelevant inasmuch as
20 there is a market price in that what we are seeking on
21 a going forward basis is to be on a level playing
22 field with our future ALEC competitors.

23 It would be discriminatory for Sprint to be
24 charged, say, a higher price for a service than AT&T
25 simply because we, perhaps, going into the docket

1 would have had a different pricing philosophy or
2 different costing methodology; that once a market
3 price has been established in the early stages of
4 competition, pretty much all players need to live by
5 that price.

6 And so the substance of my testimony and my
7 position today can really be boiled down to this one
8 point of -- is that we are seeking a market price
9 that's already been established by this Commission,
10 and we're willing to accept all rates, terms and
11 conditions that have been established therein.

12 **Q** Does that conclude your summary?

13 **A** Yes, it does.

14 **MR. FINCHER:** The witness is available for
15 cross examination.

16 **MR. McCORMICK:** Thank you, Commissioner
17 Kiesling.

18 **CROSS EXAMINATION**

19 **BY MR. McCORMICK:**

20 **Q** Good morning, Mr. Stahly. My name is Bert
21 McCormick.

22 **A** Good morning.

23 **Q** Let's talk about restrictions on resale as a
24 first topic. Is it fair to say that under the
25 Telecommunications Act there's some flexibility for

1 this Commission to determine what restrictions should
2 be placed on services available for resale?

3 A Yes.

4 Q So this Commission may place reasonable
5 nondiscriminatory restrictions?

6 A Yes.

7 Q On services available. Do you agree with,
8 necessarily, that there are some services which are
9 sold below cost by local exchange carriers?

10 A I believe GTE represented in their testimony
11 that local -- or that 1-R residential service was sold
12 below cost.

13 Q And a LEC like GTE or Sprint's United
14 Division can survive by selling those below cost
15 services because those services are, in effect,
16 subsidized by contributions from above cost services,
17 aren't they?

18 A Yes, they are.

19 Q And do you agree that GTE's services for
20 resale should not be priced below cost?

21 A Well, they should be priced at the avoided
22 costs. I mean, all services should be available for
23 resale and they should be priced at the avoided costs
24 regardless of whether the retail price is above or
25 below what you would offer as the cost.

1 Q So Sprint's position is, though, if there's
2 a below cost service, like residential service, that
3 should be available to Sprint on a below cost basis?

4 A Yes. The only -- well, yes. And let me
5 explain how that would work in that when you add or
6 take away the avoided cost discount off that retail
7 service, the only revenue they are losing is that 13%
8 of the price which is washed out by the costs that
9 they avoid when they wholesale that service. So GTE
10 should really be indifferent between selling 1-R
11 service on a retail basis or a wholesale basis.

12 Q Is that also the position of Sprint/United,
13 that it will sell below cost services?

14 A It -- yes.

15 Q What states has United taken that position
16 in?

17 A I know that we have filed in this state with
18 the arbitration proceeding with MCI. I'm not fully
19 aware of all states. I believe New Jersey, also.

20 Q That United will make below cost services
21 available for resale?

22 A Yes. We will sell -- and I believe it's my
23 understanding that we will do that in all territories
24 that we operate in.

25 Q What is Sprint's position regarding

1 promotions that are available? Should there be any
2 restriction on promotions?

3 **A** Sprint's position is in line with the FCC's
4 order in that promotions longer than 90 days, we would
5 offer at a discounted wholesale rate; promotions less
6 than 90 days, we would not.

7 **Q** Is the basis of your position that you fear
8 that GTE would make some type of a promotion available
9 for longer than 90 days and that you wouldn't be able
10 to avail yourself of those rates?

11 **A** I'm not sure I follow your question. I
12 mean, the basis of our position is that we will comply
13 with the FCC order, and we feel it's fairly good.

14 **Q** Well, now you understand that GTE's position
15 is that it doesn't restrict promotional offers to
16 days; it simply takes the position that promotional
17 offers should not be available for resale; isn't that
18 right?

19 **A** That's correct.

20 **Q** And I'm trying to understand the basis of
21 your stopping at the 90 days is simply based on the
22 FCC's position?

23 **A** Yes. We wanted to comply with the FCC
24 order, and we took that as a reasonable benchmark.

25 **Q** Does Sprint currently offer any promotions

1 that last for greater than 90 days?

2 **MR. FINCHER:** Commissioner, I would like to
3 object to that line of questioning. I let him go a
4 little bit too far, I think, but that is not an issue
5 that is addressed in Mr. Stahly's testimony. He's
6 restricted to Issues 2, 5 and 10, and that does not
7 include wholesale prices.

8 **COMMISSIONER KIESLING:** What in his direct
9 are you --

10 **MR. McCORMICK:** Perhaps I'm confused,
11 Commissioner Kiesling. I thought he was addressing
12 all pricing issues, but if this is not part of his
13 testimony, I'll move on.

14 **COMMISSIONER KIESLING:** Well, I'm not going
15 to rule that it is or isn't. I mean, that's up to
16 you. If you can show me where it is, then you can ask
17 the questions. If you can't show me where it is in
18 his testimony, then you can't.

19 **MR. McCORMICK:** Let me move on to another
20 topic and someone can find it.

21 **Q** **(By Mr. McCormick)** The concept of avoided
22 cost is in your testimony, isn't it, Mr. Stahly?

23 **A** Yes, it is.

24 **Q** And you're familiar with the FCC's
25 definition of direct expenses in connection with the

1 contexts of resale?

2 A Yes, I am.

3 Q The FCC defines a direct expense as product
4 management sales; there's about six accounts in the
5 FCC's definition of it?

6 A Yes, that's correct.

7 Q And in discussing those direct costs, the
8 FCC also says that the presumptions that those costs
9 may be rebutted or avoided -- I'm sorry, let me
10 rephrase that. In discussing those direct costs, the
11 FCC says that the presumptions that those costs may be
12 avoided is a rebuttable presumption, doesn't it?

13 A Yes, that's correct.

14 Q In your testimony at page -- (pause) --

15 A Would it be my direct?

16 Q Page 40 in your original testimony at Line 5
17 you speak of the term "avoidable costs". Do you see
18 that, sir?

19 A Yes, I do.

20 Q Now, that's a term from the First Report and
21 Order?

22 A Yes, it is.

23 Q That's not a term that appears in the
24 Telecommunications Act, is it?

25 A It does not.

1 Q Are you aware -- let me -- (pause) --
2 Commissioner Kiesling, I would like to have marked for
3 identification as GTE's next exhibit of an amicus
4 curiae brief which was filed with the 8th Circuit
5 earlier this week by four congressmen; and I'd like to
6 ask Mr. Stahly a couple questions about that.

7 COMMISSIONER KIESLING: Well, I'll mark it,
8 but that doesn't mean you're going to get to ask the
9 questions until we figure out what the objections may
10 be.

11 All right. I've marked a document that is
12 styled "Amicus Curiae Brief of John Dingle -- well, of
13 several, all of whom have tough names, of four
14 congressmen, as Exhibit 9.

15 MR. FINCHER: Commissioner, we object to
16 this. This is the first time we've seen it. It is
17 not -- we don't know if it's relevant or not to this
18 proceeding. It does not relate to anything that
19 Mr. Stahly is presenting in his testimony. We object
20 to it.

21 COMMISSIONER KIESLING: Well, I think what
22 you have to do is wait until he asks a question about
23 it and then object, because I'm not admitting it right
24 now; I'm just marking it. But you may ask your first
25 question on it.

1 Q (By Mr. McCormick) Mr. Stahly, have you
2 ever seen GTE Exhibit 9 before?

3 A I have not.

4 Q Turn, if you would, to the first page of the
5 brief, which is after the first three introductory
6 pages.

7 A Page 4?

8 Q It's the first page, and it starts with a
9 style.

10 A Okay.

11 Q And it's about the fourth page in, after the
12 roman numeral paginated numbers. It does not have a
13 page number at the bottom, but it's Page 1. Oh, I'm
14 sorry. It's the first page of your exhibit; it's not
15 of mine.

16 A Thank you.

17 Q It says that "amici or members of Congress
18 who have a strong institutional interest in ensuring
19 that federal agencies correctly interpret statutory
20 provisions." Do you see that?

21 A I do.

22 Q And I'll represent to you that the brief is
23 filed in the 8th Circuit by four members of Congress
24 who are members of the committee on commerce, the same
25 committee that wrote the Telecommunications Act, and

1 that's on the top of Page 2 that representation is set
2 forth.

3 **COMMISSIONER KIESLING:** Why don't you ask
4 him a question instead of testifying right now,
5 because I don't want you to be getting things in that
6 if I decide this is not relevant, you couldn't get in
7 otherwise.

8 **MR. McCORMICK:** That's okay, Commissioner.
9 I was just trying to lay the framework for it.

10 **COMMISSIONER KIESLING:** Fine.

11 **Q** **(By Mr. McCormick)** Turn if you would,
12 Mr. Stahly, to Page 18 of the brief, and do you see
13 the middle paragraph on that page where it talks about
14 costs that can be avoided?

15 **A** Yes. That "yet the Commission set wholesale
16 price," that paragraph?

17 **Q** And then it says, "It reopened debate on the
18 rejected avoidable costs proposal and then adopted
19 it." Do you see that, sir?

20 **A** Yes.

21 **Q** And these members of Congress have stated to
22 the 8th Circuit that the FCC --

23 **COMMISSIONER KIESLING:** Mr. McCormick,
24 what's your question to this witness? I mean, asking
25 him to read from this document is not appropriate

1 cross examination. What's your question from him?

2 Q (By Mr. McCormick) Let me ask you,
3 Mr. Stahly, would you agree with me that the concept
4 of avoidable cost is not one that was envisioned by
5 Congress in the Telecommunications Act?

6 A Are you asking me as it relates to this
7 document?

8 Q Let me ask you generally first. Do you
9 believe that to be true?

10 A Could you restate the question, because I
11 want to make sure I get to what you're looking for.

12 Q Is the concept of avoidable costs as opposed
13 to avoided costs one which was rejected by Congress in
14 passing the telecommunications act?

15 MR. FINCHER: I would object to that
16 question. It calls for speculation by the witness.

17 COMMISSIONER KIESLING: Well, I think I read
18 into the question "if you know," because obviously if
19 he doesn't know, that's an appropriate answer.

20 WITNESS STAHLY: And I would answer I don't
21 know.

22 Q (By Mr. McCormick) Would you agree with me
23 based on GTE Exhibit 9 at least four members of
24 Congress have represented that to the 8th Circuit?

25 MR. FINCHER: I object to the question.

1 **COMMISSIONER KIESLING:** What's your
2 objection?

3 **MR. FINCHER:** I object to this whole line of
4 questioning, Commissioner, on this document. I think
5 that we just saw it today. He's asking the witness to
6 speculate as to what these commissioners -- or what
7 these congressmen intended when they filed this
8 document, what their position was, whether these
9 concepts were accepted or rejected when the
10 Telecommunications Act was passed. I think it's
11 improper and I just object to it. It's just --

12 **COMMISSIONER KIESLING:** Well, that's
13 exciting. It's very difficult for me to hear argument
14 and make a ruling on an objection that is just "it's
15 objectionable." I mean, what is the basis for your
16 objection to that question?

17 **MR. FINCHER:** I'll withdraw the objection.

18 **COMMISSIONER KIESLING:** Okay. Do you want
19 to re-ask your question?

20 **MR. McCORMICK:** Certainly, Commissioner.

21 **Q** **(By Mr. McCormick)** Mr. Stahly, would you
22 agree with me, then, based on GTE Exhibit 9, it's fair
23 to say that these members of Congress are telling the
24 8th Circuit the concept of avoidable costs was
25 rejected by Congress in passing the Telecommunications

1 Act?

2 **A** Can I have some time to read this document?

3 **COMMISSIONER KIESLING:** Well, you can also
4 say that you won't agree because you haven't read it,
5 you've never seen it.

6 **WITNESS STAHLY:** I'm really not familiar
7 with this document and haven't had time to thoroughly
8 evaluate it, so I really can't address that.

9 **Q** Well, let me ask you this: Does this
10 Commission need to decide this case in accordance with
11 the Telecommunications Act?

12 **A** Well, yes, they should do it in accordance
13 with the Act.

14 **Q** And would you agree with me that the
15 congressmen who drafted the Act would know what they
16 meant by the Act when it was written?

17 **MR. FINCHER:** Object. Calls for
18 speculation, what congressmen knew or did not know
19 when they drafted the Act.

20 **COMMISSIONER KIESLING:** Sustained.

21 **MR. McCORMICK:** Commissioner Kiesling, we
22 would offer GTE Exhibit 9 into evidence. I think it's
23 relevant as to the intent of Congress, and I think
24 it's evidence the Commission ought to consider in
25 determining what the meaning of the Telecommunications

1 Act is.

2 Whether avoidable or avoided cost is the
3 standard I think is an issue between the parties, and
4 I think Exhibit 9 sheds quite a bit of light on what
5 Congress meant.

6 **COMMISSIONER KIESLING:** Are you through with
7 your cross examination?

8 **MR. McCORMICK:** No --

9 **COMMISSIONER KIESLING:** Ordinarily we move
10 exhibits at the end.

11 **MR. McCORMICK:** Okay. I can save it and
12 move it at the end.

13 **COMMISSIONER KIESLING:** Yes. That's why I
14 wasn't sure if you were through with your cross.

15 **MR. McCORMICK:** No.

16 **COMMISSIONER KIESLING:** Okay.

17 **Q** (By Mr. McCormick) Mr. Stahly, let's
18 resume talking about avoided costs.

19 **A** Okay.

20 **Q** What analysis have you done of GTE's cost to
21 determine whether the costs in the direct expense
22 accounts can be reasonably avoided?

23 **A** I have reviewed GTE's proposed cost studies
24 and I've reviewed what the Commission found to be
25 reasonable, and again would go back to the point of

1 with the market price set, that regardless of
2 differences in philosophy, we need a level playing
3 field and a market price.

4 Q Do you agree with the avoided cost discount?
5 Putting aside any issue about what AT&T gets, but just
6 in the abstract, do you agree with the avoided cost
7 discount that GTE proposes?

8 A The 5 or 7% that you proposed?

9 Q Yes, sir.

10 A No, I do not.

11 Q In your opinion what should the avoided cost
12 discount be?

13 A I have not, of my own, conducted an avoided
14 cost study, but I would think the Commission came
15 closer to what that avoided cost should be.

16 Q The Commission, meaning the FCC?

17 A No, the Florida Commission with the docket
18 earlier this week.

19 Q And that was a 13% avoided cost?

20 A Yes.

21 Q Putting aside that ruling, do you have any
22 independent opinion as to what avoided costs ought to
23 be?

24 A Again, there would be the FCC investigation
25 which pointed out as reasonable 18.8%.

1 Q But it's your opinion that it should not be
2 an 18% discount, 13% would be appropriate?

3 A It's my opinion that we should get what was
4 ever ordered in the AT&T/GTE arbitration, which is
5 13%.

6 Q Suppose that had been a 7% discount. Would
7 you agree with that, too?

8 A If that was the market price set, we would
9 ask for the market price. We would not necessarily
10 say that that was necessarily a corrective way to
11 cost, but simply that we would be on a level playing
12 field with other players.

13 Q Do you agree that even though GTE may avoid
14 some retail costs when it sells services to Sprint on
15 a wholesale basis, that they will be new costs that
16 arise?

17 A They will incur some costs selling to the
18 wholesale market, yes.

19 Q And you agree that those new costs ought to
20 be offset from any avoided costs, so it's really a net
21 avoided cost?

22 A Yes, they should consider those.

23 Q And you also agree with me that before the
24 FCC Sprint advocated that the FCC adopt low avoided
25 discounts, didn't it?

1 A That was our position at that time.

2 Q And that was because of concerns for
3 Sprint's United division, which was an ILEC?

4 A I think that was simply Sprint's analysis of
5 the docket in its entirety.

6 Q And it's fair to say that Sprint has taken
7 the position in other states, such as California, that
8 GTE's avoided cost studies were reasonable; isn't that
9 right?

10 A That was prior to the FCC order, and that
11 was our position in that docket, yes.

12 Q Before the FCC came out with the default
13 proxy rates, Sprint agreed that AT& -- that GTE's
14 avoided costs were reasonable?

15 A Prior to the FCC docket, yes.

16 Q And you also agree that the policy thrust of
17 the Telecommunications Act is to promote efficient
18 competition in telecommunications markets, don't you?

19 A Yes.

20 Q So you would agree that this Commission
21 should not adopt any pricing rules that encourage
22 inefficient entries into the local exchange market,
23 don't you?

24 A Yes.

25 Q It's also true that the purposes of the

1 Telecommunications Act are not served by subsidizing
2 entry into the local market, are they?

3 **A** Well, that's an interesting question, and
4 only from that I take it back from the perspective of
5 you look at the deregulation of the long distance
6 market where there clearly were some advantages given
7 to the new entrants to help them build up market
8 share. So I'm not sure that that would be a straight
9 yes answer.

10 **Q** Okay. Well, do you agree that prices for
11 interconnection and unbundled network elements should
12 be subsidy free?

13 **A** I believe they should be priced at the --
14 you know, the TELRIC price plus the appropriate
15 allocation of forward looking common costs, which
16 would recover your costs and have no subsidies.

17 **Q** So if those services or elements were priced
18 below economic costs, wouldn't that amount to a
19 subsidy?

20 **A** I'm not sure of your definition of economic
21 costs. If you price at the TELRIC standard, you are
22 fully recovering your costs.

23 **Q** Do you agree that prices of unbundled
24 network elements ought to be priced above cost?

25 **A** Above their TELRIC, underlying TELRIC costs,

1 yes.

2 Q And it's Sprint's position that really the
3 pricing methodology should be TELRIC plus a reasonable
4 share of forward-looking common costs; isn't that
5 right?

6 A Yes.

7 Q And it's fair to say that GTE and Sprint
8 agree on that proposition, don't they?

9 A I think the general industry agrees on the
10 overall concept. It's just when you get down to the
11 details of how much, et cetera, that there is
12 disagreement.

13 Q Well, certainly you're not saying that AT&T
14 agrees on that methodology, are you?

15 A I'm not fully familiar with their
16 methodology.

17 Q But, nevertheless, Sprint and GTE do agree
18 on it, we just disagree on the size of the common
19 costs, don't we?

20 A I'll say very generally that is correct.

21 Q And you're familiar with the concept of
22 economies of scale, aren't you?

23 A Yes, I am.

24 Q Economies of scale is desirable certainly,
25 isn't it?

1 A I don't know if desirable is the term, but I
2 mean, there are economies of scale, and prices should
3 reflect those economies of scale.

4 Q It's fair to say that an incumbent LEC
5 enjoys significant economies of scale and scope,
6 doesn't it?

7 A I'm not sure in what respect you're
8 referring to, compared to what.

9 Q Well, now, you have a background in
10 economics, don't you?

11 A Yes, I do.

12 Q So you've heard the term "economies of
13 scale."

14 A I do, but I --

15 Q You understand what it means?

16 A Yes, I do.

17 Q Do you not think an incumbent LEC like GTE
18 or Sprint/United enjoys significant econ -- of
19 economies of scale?

20 A Generally speaking, there are economies of
21 scale, but I'm not sure what you're getting at.

22 Q Well, do you agree with the statement in
23 paragraph 11 of the First Report and Order that
24 incumbent LECs have economies of scale?

25 A Could I see a copy of that paragraph?

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Q Sure.

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(Transcript continues in sequence in
Volume 3.)