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September 20, 1996

Ms. Blanca S. Bayo, Director
Division of Records & Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 960847-TP
Petition by AT&T Communications of the Southern States, Inc. for arbitration of certain terms and conditions of a proposed agreement with GTE Florida Incorporated concerning interconnection and resale under the Telecommunications Act of 1996

Re: Docket No. 960980-TP
Petition by MCI Telecommunications Corporation and MCI Metro Access Transmission Services, Inc. for arbitration of certain terms and conditions of a proposed agreement with GTE Florida Incorporated concerning interconnection and resale under the Telecommunications Act of 1996

Dear Ms. Bayo:

Please find enclosed for filing an original and fifteen copies of GTE Florida Incorporated's Response to the Petition for Arbitration of MCI Telecommunications Corporation and MCI Metro Access Transmission Services, Inc. in the above matter. We have provided MCI copies of GTE Florida's direct testimony, its proposed interconnection and resale contract, and associated materials filed in Docket No. 960847-TP.

Service has been made as indicated on the Certificate of Service. If there are any questions regarding this matter, please contact me at (813) 228-3087.

Very truly yours,

Anthony P. Gillman

APG:tas
Enclosures

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that copies of GTE Florida Incorporated's Response to the Petition for Arbitration of MCI Telecommunications Corporation and MCI Metro Access Transmission Services, Inc. in Docket No. 960980-TP were hand-delivered (*) or sent via overnight mail (**) on September 20, 1996 to the parties listed below.

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SECTION II

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by AT&T Communications of the Southern States, Inc. for Arbitration of Certain Terms and Conditions of a Proposed Agreement with GTE Florida Incorporated Concerning Interconnection and Resale under the Telecommunications Act of 1996	Docket No. 960847-TP
In re: Petition by MCI Telecommunications Corporation and MCI Metro Access Transmission Services, Inc. for arbitration of certain terms and conditions of a proposed agreement with GTE Florida Incorporated concerning interconnection and resale under the Telecommunications Act of 1996	Docket No. 960980-TP Filed: September 20, 1996

ARBITRATION BRIEF OF
GTE FLORIDA INCORPORATED

Introduction

The Telecommunications Act of 1996 (the "Act") held out great promise to usher in an era of facilities-based competition in the local exchange telephone market. To accomplish this end, Congress required incumbent local exchange carriers ("ILECs"), like GTE, to open up their networks to competitors by mandating interconnection, unbundling of the network, and the sale of retail services at wholesale prices. Rather than imposing prices from the federal level, Congress opted for market-based pricing by establishing a negotiation process between the parties. As a backstop, Congress chose the States (through their public utility commissions) to discipline the negotiation process by establishing prices for local service through State-sponsored arbitrations when the parties

cannot voluntarily reach agreement. Congress was concerned, however, not only with ensuring access to the local network but also with ensuring that ILECs recover their costs and earn a reasonable profit on their investments. In short, the Act is all about fostering competition -- not protecting competitors.

Contrary to the mandate of Congress, the Federal Communications Commission ("FCC"), in its First Report and Order,[1] broke with every major principle underlying the Act. In violation of Section 2(b) of the Communications Act, the FCC has attempted to strip the States of their rightful role in establishing local telephone rates for intra-State service by establishing elaborate pricing methodologies and default proxy rates. In violation of the Act and the Constitution's prohibition against an uncompensated taking of GTE's property, the FCC's pricing rules and default rates ensure that ILECs will not recover all of their forward-looking costs or historic costs of the network. Likewise, the FCC has resolved countless other issues concerning unbundling, resale, and interconnection in a way that favors competitors -- not competition.

MCI's position in this arbitration takes advantage of the mistakes committed by the FCC.[2] MCI proposes rates that would force GTE to sell its services at below cost, and MCI would have this Commission impose unjustified rates that would effect an uncompensated unconstitutional taking of GTE's property. There can be no question either that the FCC's

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[1] In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket No. 96-98, FCC 96-325 (released August 8, 1996) ("First Report And Order").

[2] See MCI's Petition For Arbitration Under the Telecommunications Act of 1996 filed against GTE Florida (filed August 26, 1996) ("MCI Petition").

price rules, if followed, would compel GTE to subsidize MCI's entry into the local telephone market. Whatever economic theory it is that leads to that result, it is not "competition" and not envisioned by the Act.

The heart of this case – and the principal task of this Commission – is to establish a framework for promoting full and fair competition in the local exchange market while at the same time ensuring that consumers receive the benefits of competition. In simple terms, the Commission must resolve the disputed issues in such a way as to promote competition, not the self-serving interests of a particular competitor.[3]

The Commission cannot achieve this goal unless it adopts a pricing methodology that encourages efficient entry into the telecommunications market, encourages facilities-based competition, and sends pricing signals that will maximize consumer welfare by maximizing consumer choice. To this end, GTE urges the Commission to adopt its pricing methodology -- the Market-Determined Efficient Component Pricing Rule ("M-ECPR") -- which will achieve all the Commission's goals. As explained in more detail in the Direct Testimony of David S. Sibley and below in Parts II-III, M-ECPR is a market-based method for determining GTE's share of forward-looking joint and common costs that should be allocated to prices for its unbundled network elements. This model does not permit GTE to charge a price for an unbundled element that exceeds the market price. With respect

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[3] While pricing and costing are the main issues raised by this arbitration, there are numerous other related issues that still remain open between the parties. These issues are reflected in the list of issues compiled by Staff as a result of the issues identification conference in this docket on September 12 and 13.

to resold services, M-ECPR similarly derives a price that reflects GTE's costs of providing those services. Notably, M-ECPR is not a "make-whole" remedy.

This brief begins with an overview of the many reasons why the Commission should not, and need not, follow the FCC's wrongheaded approach to the Telecommunications Act of 1996. (See Part I below.) Next, we address the principal issue of this arbitration -- establishing the costing and pricing for unbundled network elements and resold services in such a way that will allow GTE to recover its costs. (Parts II-III.) In addition, we focus on a number of other cost-recovery issues. (Part IV). Finally, we address the FCC's and MCI's overly broad definition of what is technically feasible, which is untethered to real-world concerns (like cost, space, time etc.). (Part V.) If MCI's position were adopted, then GTE would be forced to underwrite yet another cost of MCI's market entry.

Discussion

I. THE COMMISSION IS NOT BOUND BY AND SHOULD NOT FOLLOW THE FCC'S PRICING METHODOLOGIES OR DEFAULT PROXY RATES.

A. Introduction.

To the extent that MCI supports the Commission's adoption of the FCC's pricing rules and default proxy rates, this position should be rejected for at least three reasons: (1) the FCC exceeded its authority under the Act by mandating certain pricing methodologies and by preempting States from considering other methodologies; (2) the FCC's default rates are flawed and based on erroneous assumptions; and (3) the FCC's pricing methodologies and default rates, if adopted, would result in a taking of GTE's property without just compensation in violation of the Fifth and Fourteenth Amendments,

because these price rules and default rates would set prices that are substantially below GTE's actual costs. We address each of these reasons below (Parts I.B-D).

B. The FCC Exceeded Its Authority By Usurping The Commission's Power.

MCI is requesting interconnection, services, and unbundled elements under § 251(c) of the Act. The prices for these facilities and services are subject to the pricing standards set forth in § 252(d)(1)-(3). The Act expressly provides that the State commissions have exclusive authority to establish and apply these standards:

> ***(d) Pricing Standards.***
>
> (1) Interconnection and network element charges. Determinations by a ***State commission*** of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section --
>
> * * *
>
> (2) Charges for transport and termination of traffic.
>
> (A) In general. For the purposes of compliance by an incumbent local exchange carrier with section 251(b)(5), a ***State commission*** shall not consider the terms and conditions for reciprocal compensation to be just and reasonable unless --
>
> * * *
>
> (3) Wholesale prices for telecommunications services. For the purposes of section 251(c)(4), a ***State commission*** shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

47 U.S.C. § 252(d)(1)-(3) (emphases added).

Congress' Section 251(d) mandate that State commissions alone are authorized to set prices is confirmed by Section 2(b) of the Communications Act. Section 2(b) explicitly restricts the FCC's authority as it provides that "nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communication service." 47 U.S.C. § 152(b). Under the plain terms of this section, the FCC does not have the power to promulgate rules governing pricing for the type of agreements concerning local services that will be concluded under Section 251, and indeed lacks any authority to regulate matters purely within the local exchange. This "congressional denial of power to the FCC" in Section 2(b), moreover, could only be circumvented if Congress included "unambiguous" and "straightforward" language in the Act either modifying Section 2(b) or, at a minimum, explicitly granting the Commission added authority. See Louisiana Public Serv. Comm'n v. FCC, 476 U.S. 355, 375, 377 (1986). But no provision in the 1996 Act expressly modifies Section 2(b) to grant the FCC authority to regulate either prices or other local matters under Section 251. To the contrary, such a provision was expressly rejected by Congress, for while it was included in the Senate bill, it was not included in the law as enacted. See Conf. Rep. No. 458, 104th Cong., 1st Sess. § 101(c) (1996). And as the FCC itself has acknowledged, Section 251 includes no "explicit grant of intrastate authority to the [FCC]." First Report and Order ¶84.

Notwithstanding the Act's plain and unambiguous language, the FCC has established detailed rules and methodologies for these pricing standards, and has

precluded States from considering other methodologies.[4] Moreover, the FCC has established default rates that States must apply until such time as they establish rates that comply with the FCC-mandated pricing methodologies. Quite simply, the FCC has limited the role of State commissions to that of a rubber stamp. But this is not what the Act intends. No agency, including the FCC, can undo the fundamental decision enacted by Congress and signed into law that it is the States that have the primary responsibility for determining pricing.

In short, the FCC exceeded its jurisdictional authority by mandating specific pricing methodologies and preempting States; therefore, any reliance on these methodologies and rates is misplaced. GTE respectfully requests that the Commission (1) disregard the FCC's mandatory pricing rules as an unlawful usurpation of State power and (2) adopt GTE's pricing and avoided-cost methodologies, which satisfy the Act's requirement that GTE and other incumbent LECs recover their true costs.

C. <u>The FCC's Default Rates Are Wrong</u>.

Not only did the FCC exceed its authority by setting default rates, but it compounded its error by relying upon erroneous assumptions and flawed studies in setting the rates. This conclusion is illustrated by examining how the FCC selected its default discount rates for wholesale services.

In setting default rates for wholesale services, the FCC attempted to adjust MCI's avoided-cost model to reflect the fact that an incumbent LEC will incur (and therefore

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[4] First Report and Order at ¶¶ 619, 629, 672-732.

should recover) additional costs associated with wholesale services, such as wholesale costs for product management, advertising, and sales. The FCC admitted that there was no evidence upon which to make an adjustment, so it simply "assumed" a default rate:

> We note that, in their own proceedings, several states have made varying estimates concerning the level of wholesale-related expenses in these accounts [ranging from 0% to 25%]. ***Given the lack of evidence***, and the wide range of estimates that have been made by these states, ***we find it reasonable to assume***, for purposes of determining a default range of wholesale discount rates, that ten percent of costs in [these accounts] are not avoided by selling services at wholesale.

Order at ¶ 928 (emphasis added).

The FCC's "given the lack of evidence . . . we find it reasonable to assume" approach is, by definition, arbitrary and capricious. In fact, Webster's Dictionary defines the word "arbitrary" as "unsupported." The FCC said, explicitly, that it had no evidentiary support to make a finding, but nevertheless did so. Making decisions in this manner falls squarely within the definition of "arbitrary" and "capricious", in violation of the Administrative Procedure Act, 5 U.S.C. § 706(2)(A). See also Motor Vehicles Mfs. Ass'n v. State Farm Mut'l Auto. Ins. Co., 463 U.S. 29, 43 (1983) (an agency must "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made"); Competitive Telecommunications Ass'n v. FCC, 87 F.3d 522, 536 (D.C. Cir. 1996) (rejecting FCC rates because "the Commission did not give a reasoned explanation why its adoption [of an interconnection charge] was necessary or appropriate and consistent with the agency's

statutory responsibilities"). Here, the FCC's arbitrary action is yet another reason for the Commission not to rely upon the default proxy rates.

The FCC continued its arbitrary approach to rate-making by setting default rates for unbundled loops. This conclusion is illustrated by examining how the FCC selected its default rate for unbundled loops in Florida. In its First Report and Order, the FCC explained that it was setting default rates based on two cost models and on the unbundled loop rates established by six states, including Florida, that had conducted actual cost studies. First Report and Order at ¶ 792. Those cost studies, however, and in particular the Florida studies, were not based on the FCC's TELRIC method.[5] To the contrary, the Florida studies used a TSLRIC approach and omitted any significant contribution for joint and common costs. These studies systematically understate the costs properly included under the FCC's TELRIC approach. As the FCC noted elsewhere in its Order, the TSLRIC studies prepared by various parties provide a measure of cost lower than TELRIC, and the FCC's pricing standard, unlike the standard used in Florida, expressly requires a "reasonable allocation of joint and common costs." Id. at ¶ 672, 682.

The FCC compounded its error by choosing -- again without explanation -- a proxy rate for Florida that cannot logically be reconciled with the very studies on which the FCC relied. Based on the TSLRIC studies presented to it, the Florida Commission approved a loop price that produced an overall State-weighted average price of $17.28. Given that

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[5] There is no meaningful distinction between TSLRIC and the Total Element Long Run Incremental Cost (TELRIC) approach adopted by the FCC. The FCC chose to call its version "TELRIC" to take account of the fact that LRIC pricing was intended to apply to each unbundled Element of the network -- not just the Network itself.

Florida calculated a loop price based on TSLRIC studies that did not include any significant joint and common costs, one would assume that the FCC's proxy rate for Florida -- which is intended to reflect the FCC's TELRIC methodology and include a reasonable share of joint and common costs -- would be greater than the $17.28 average rate adopted in Florida. One would be wrong. Without any explanation, the FCC set the average proxy rates for loops in Florida at $13.68, more than 20% less than the average rate set by the Florida Commission. This result cannot be squared with the Florida studies. For all that appears from the Order, the FCC might just as well have picked its default prices out of a hat. The FCC failed completely in its obligation to meet the requirements of reasoned decision making, and the Commission is not bound by the FCC's decision.

The FCC similarly failed to measure up to the standards of reasoned decision making in setting the default prices for unbundled switching. As defined by the FCC, the unbundled end office switching element includes not only the basic switching function of connecting lines and trunks, but also the full range of "features, functions, and capabilities of the switch," including "vertical switching features, such as custom calling and CLASS features." First Report and Order at ¶ 410, 412.

The studies on which the FCC set its default rates, however, were based only on those costs associated with providing a much more narrowly defined switching function. In fact, these studies focused only on those costs associated with transporting additional minutes of traffic from an interconnecting carrier across the local switch. These studies did not purport to examine the costs associated with providing all the "features, functions and capabilities" of the switch. Moreover, these studies considered only the incremental

cost of additional minutes of traffic and made no attempt to measure average costs. Accordingly, the studies relied upon by the FCC made no allowance for recovering the joint and common costs expressly required by the FCC's own rules. Here again, the FCC failed to address the discrepancies between the evidence on which it was relying and its own definitions of both the network element in question and the relevant measure of costs. In the absence of any effort to reconcile the studies with its own rules, the FCC's decision is plainly arbitrary.

D. The FCC's Default Rates Would Result In a Fifth Amendment Taking.

The FCC's default rates are not fully compensatory because they would not allow GTE to recover all its costs. Accordingly, the FCC's default rates violate the Act's requirement and the Fifth Amendment's requirement that GTE receive "just and reasonable" compensation for the taking of its property. See, e.g., Brooks-Scanlon Co. v. Railroad Commissioner, 251 U.S. 396 (1920); see also Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982).

This constitutional analysis applies not only to the FCC's default rates, but also to MCI's pricing methodologies. The regulatory and physical takings issues raised by the FCC's default rates and these pricing methodologies are discussed in detail in our separate brief on Fifth Amendment Takings.[6] In that brief, we explain why this Commission must interpret the Act so as to provide for the recovery of at least all of GTE's historic and forward-looking costs of unbundled elements or resold services, including a reasonable profit. Indeed, if the Act were interpreted otherwise, it would effect a taking of GTE's

[6] See "Takings Report" which is part of GTE's Response to MCI's Petition.

property without just compensation in violation of the Fifth and Fourteenth Amendments of the U.S. Constitution and Article 10, Section 6 of our State Constitution. Under familiar principles of statutory construction, such an interpretation must be avoided because the Commission must read the Act to avoid serious constitutional questions. See, e.g., Rust v. Sullivan, 500 U.S. 173, 190-91 (1991); Ashwander v. Tennessee Valley Auth'y, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring).

II. PROPER PRICING OF INTERCONNECTION AND UNBUNDLED ELEMENTS.

A. Introduction.

We explain in greater detail in Report VIII that the proper method for pricing interconnection and unbundled network elements begins with the market-determined efficient component pricing rule. Under M-ECPR pricing,[7] the Commission would establish prices for unbundled elements that would reflect all of GTE's true forward-looking costs. In addition, any price set by the Commission should further reflect any costs to GTE of actually unbundling the network element.

Because M-ECPR is a forward-looking market-based model, however, it fails to capture all of GTE's true network costs. First, GTE will not recover all of its forward-looking costs through M-ECPR, as would regulated rates absent competitive entry. That means there will be "stranded costs" -- defined as revenues under regulation less

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[7] M-ECPR is the identical methodology that GTE submitted to the FCC in connection with the Interconnection Docket 96-98. It has been designated "M-ECPR" here to avoid any possible confusion because the FCC's version of ECPR bore no relationship to the version submitted by GTE. In short, M-ECPR is not the simplistic, strawman version of ECPR that the FCC created and then destroyed in its First Report and Order.

revenues under competition (on a present value basis). Second, GTE will not recover, and earn a fair rate of return on, its historic investments in the very network with which MCI now seeks interconnection.

Both the shortfall in forward-looking costs and historic costs presents a significant but ***separate*** issue for this Commission. As explained more fully in the Sibley Direct Testimony, an end-user charge is necessary to allow GTE to recover these costs. Without a full recovery of all of its forward-looking and historic costs, GTE would be forced to fund the transition from regulation to competition, it would subsidize not only MCI's entry into the market but its continued operation as well, and it would constitute an unconstitutional taking of GTE's property without just compensation.

MCI, on the other hand, contends that GTE's rates for interconnection and unbundled elements should be set at TELRIC. This pricing methodology contains many flaws, several of which we address here.

B. MCI's Approach Ignores Joint and Common Costs.

First, MCI's TELRIC approach does not provide for recovery of GTE's joint and common costs -- as required under the Act and the Constitution. MCI questions the existence of such costs. (Direct Testimony of Sarah J. Goodfriend at 26.) The threshold question is therefore a simple one: Does GTE have significant joint and common costs?

GTE's cost studies provide ample evidence of GTE's substantial joint and common costs. Indeed, these cost studies demonstrate that the Company's joint and common costs are more than 35% of the Company's total annual revenues. This result is not surprising, because it confirms what is written in most introductory-level economics textbooks: Firms

that possess economies of scale and scope have significant joint and common costs. In fact, the FCC itself has recognized that GTE's network enjoys significant economies of scale and scope.[8] MCI wants the benefits of these economies, but it is unwilling to pay for them.

Finally, expert economists who filed affidavits on behalf of another large interexchange carrier--AT&T--in the FCC's local competition rulemaking agree that "non-trivial" joint and common costs would result from network unbundling:

> At a finer level of disaggregation, there may well be non-trivial costs shared among various subcomponents of any particular aggregative network element. The competitive price for any such subcomponent must be between the subcomponent's unit long run incremental cost and [stand-alone cost]. The revenues from the competitive prices of all the subcomponents of an aggregative network element must sum to the long run incremental cost of the aggregative network element.

(AT&T Appendix C, Affidavit of William J. Baumol, Janusz A. Ordover, and Robert D. Willig at n.1.)

In plain English, even the expert witnesses in the interexchange carrier camp recognize that as a local telephone network is divided ("unbundled") into smaller and smaller pieces, costs that were once attributable become "unattributable" joint and common costs. Moreover, AT&T's witnesses have conceded that where joint and common costs exist, the pricing of the individual pieces of the network should be the incremental

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[8] See, e.g., Order at ¶ 679 ("As a result of the availability to competitors of the incumbent LECs' unbundled network elements at their economic cost, consumers will be able to reap the benefits of the incumbent LECs' economies of scale and scope . . . .").

cost ***plus*** a share of joint and common costs, so that all costs may be recovered. This, of course, is precisely GTE's position.

C. MCI's Unbundling and TELRIC Pricing Strategy.

MCI's TELRIC methodology is just one-half of its strategy to obtain the benefits of GTE's network without paying for them. The other half is MCI's rush to unbundle as many network elements as possible. MCI's combined unbundling/pricing strategy can be distilled to the following four principles: (1) The more you unbundle the network, the more joint and common (i.e., "unattributable") costs you create; (2) by creating more joint and common costs, you reduce the incremental (i.e., "attributable") costs for unbundled elements; (3) under MCI's TELRIC proposal, the prices for unbundled elements are set at incremental costs and exclude the appropriate level of joint and common costs; therefore (4) the more network elements MCI unbundles, the lower MCI's total costs for purchasing all the network elements.

In sum, MCI's unbundling and pricing strategy is intended to push costs from the "attributable" column to the "unattributable" column in a cost study. Of course, GTE's ***total costs*** will remain the same, but under MCI's proposal GTE will never recover its total costs, because GTE's customers and shareholders will be subsidizing MCI. One way to visualize this strategy is to think of a balloon full of hot air: When you squeeze one end, the pressure pushes most of the air to the other end, but the amount of air in the balloon remains the same at all times. MCI's pricing and unbundling strategy does the same thing – it pushes costs from the "incremental" category to the "joint and common" category, but the total costs always remain the same.

MCI asks the Commission to immediately order unbundling of loop distribution, and to approve a "bona fide request" process under which further requests of unbundling could be presumed technically feasible. The FCC's rules encourage MCI to pursue this strategy, because the rules permit MCI and other requesting carriers to unbundle elements and then reassemble them to provide end-to-end telephone service. First Report and Order at ¶ 328. These rules, however, violate the Act, which draws a distinction between the ***purchase*** of unbundled elements and the ***resale*** of wholesale services. Under the Act, unbundled elements must be provided at rates based on costs plus a reasonable profit (§ 252(d)(1)), whereas charges for resold services are set at retail rates less avoided costs (§ 252(d)(3)). These different costs serve entirely different purposes, and the "cost plus" rate for unbundled elements is intended to encourage facilities-based competition. The FCC's rules, however, render this distinction meaningless, and permit MCI to obtain existing retail ***services*** at the cost standard applicable to unbundled ***elements***. Under this scheme, MCI has little incentive to build its own facilities until it has exhausted GTE's capacity.

The FCC's rules also contradict the intent of the Act because they discourage investment by incumbent LECs. What economic incentive is there for an incumbent LEC to invest in the research and development of new technologies? The very day the ILEC deploys these technologies, MCI "unbundles" them, obtains them at TELRIC prices, and reassembles them. Congress could not have intended such an illogical result.

D. MCI's Approach Ignores GTE's Historic Costs.

Another flaw in MCI's TELRIC approach is that it does not allow GTE to recover that portion of its prudently incurred embedded costs not already recovered. As mentioned above, GTE must recover these costs or else there would be a taking without just compensation. In addition, MCI's proposal is flawed because it relies on the "Hatfield Model," which simply does not work. As discussed in Dr. Gregory Duncan's testimony on the Hatfield Model, the theoretical network spawned by this model will never be constructed and will never carry a single call. Yet this model serves as the foundation for much of MCI's case.

The model is also fundamentally flawed in another way: It assumes that the Act permits prices to be set on the basis of something other than GTE's actual costs. But nowhere does the Act provide for this. To the contrary, the Act recognizes that prices must be based on the incumbent LEC's actual costs. For example, § 251(c)(3) requires ILECs to provide access to its network elements. The term "network element" is defined in § 153(29) to mean "a facility or equipment ***used*** in the provision of telecommunications service." Thus, an ILEC is required to provide access to elements the ILEC ***uses*** in the provision of telecommunications service, not elements that ***could*** be used, ***should*** be used, or ***might*** be used in the provision of such service. Similarly, subsection 252(d)(1) of the Act states that the just and reasonable rates for network elements shall be based on the cost of providing the network element, not on the cost of providing a theoretical construct.

Thus, MCI's proposal is contrary to the Act. It also is contrary to the Constitution, because it would result in a taking of GTE's property in violation of the Fifth Amendment. As discussed in Dr. Sibley's Direct Testimony, GTE would be precluded from recovering its historic costs incurred prior to competition if MCI's TELRIC approach were adopted. (See Part VIII). Under the Fifth Amendment, however, GTE must have an opportunity to recover and earn a fair rate of return on this investment.

III. THE PROPER METHOD FOR PRICING RESOLD SERVICES.

As described in greater detail also in Dr. Sibley's Direct Testimony (Part VIII), the M-ECPR approach to pricing resold services similarly would provide a method for the Commission to establish prices that would reflect GTE's true costs of resale, as required by the Act and the Takings Clause. Simply put, GTE must be allowed to recover its retail price less those avoided costs that it truly avoids -- not what might be "avoidable". Moreover, GTE must be allowed to recover any costs associated with actually having to resell its services.

MCI's "avoidable" cost methodology, which is based on the FCC's flawed rules, should be rejected by the Commission. Indeed, a full appreciation of MCI's method only underscores how inappropriate and contrary to the Act its proposed strategy would be.

First, MCI's and the FCC's methodology is based on an ILEC's "avoidable" rather than "avoided" cost. The Act, however, is very clear in providing that wholesale rates shall be determined by State commissions "on the basis of retail rates charged to subscribers . . . excluding the portion thereof attributable to any marketing, billing, collection, and other costs ***that will be avoided*** by the local exchange carrier." 47 U.S.C. § 252(d)(3)

(emphasis added). Congress' use of the word "will" rather than "could" conclusively establishes that wholesale rates must be set based on the ILEC's avoided, not "avoidable," cost.

Second, MCI's and the FCC's methodology assumes that GTE will not incur ***any*** retail costs. Therefore, all of GTE's costs associated with retail sales, advertising, product management, customer services, and similar services have been excluded from MCI's avoided cost study. This assumption is, of course, absurd. To assert that GTE will not at the very least maintain its ***existing*** level of advertising expenses and other customer-support expenses defies logic and assumes that on the first day MCI enters the local telephone market, GTE will lose 100% of its retail business.

Third, as discussed in the direct testimony of GTE's witness Wellemeyer, GTE's avoided cost studies show that, based upon reasonable estimates of avoided retail expenses and additional wholesale expenses, GTE's avoided costs equate to 7%. This figure is well below MCI's proposed 17.26% rate.

Here again, MCI's proposal would not allow GTE to recover its total costs, and therefore it would result in a taking of property without just compensation.

IV. COST RECOVERY ISSUES.

A. Introduction.

Several of MCI's requests -- particularly its request for loop and switch unbundling, AIN unbundling, and operator support services – require significant modifications to GTE's existing networks; and in many instances, they would require new technologies to be

developed and deployed. The question, of course, is who should bear the cost of these modifications and technologies.

In its rules, the FCC rejected the ILECs' position that requesting carriers "take the ILEC networks as they find them." The FCC requires ILECs to take "affirmative steps" to modify their existing facilities to meet the requirements of requesting carriers. See, e.g., Order at ¶ 382. But the FCC recognizes that the ***requesting carrier*** must bear the cost of compensating the ILEC for such modifications.[9] Simply put, if a CLEC demands changes to an ILEC's network, it must pay for them.

To the extent that MCI does not agree that it should have to pay for modifications to accommodate its own requests, the Commission should reject its position. To this end, the FCC appears to place this burden on the requesting party:

> We find that the 1996 Act bars consideration of costs in determining "technically feasible" points of interconnection or access [to unbundled elements]. Of course, a requesting carrier that wishes "technically feasible" but expensive interconnection would, pursuant to section 252(d)(1), be required to bear the cost of that interconnection, including a reasonable profit.

Id. at ¶¶ 198, 199.

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[9] See, e.g., First Report and Order at ¶ 382 (the requesting carrier must bear the cost of compensating the ILEC for loop conditioning); ¶ 393 ("the new entrant bears the cost of connecting its NID to the incumbent LEC's NID"); ¶ 751 (ILECs may recover costs of collocation cages).

V. TECHNICAL FEASIBILITY.

Many of the cost recovery issues raised by MCI's request flow from the FCC's definition of technical feasibility. In its Order, the FCC adopted a very broad definition of this term:

> We conclude that the term 'technically feasible' refers solely to technical or operational concerns, rather than economic, space, or site considerations.

(First Report and Order at ¶ 198). The FCC concluded that all State commissions ***must*** apply this definition in their arbitrations. (Id. at ¶ 281).

GTE disagrees with the FCC's definition. Indeed, under this definition almost anything is "feasible," because the question of feasibility is decided in a vacuum without reference to real-world concerns such as cost, space, time, or existing network configurations. Indeed, under the FCC's definition, it might be "technically feasible" to provide telephone service from here to Mars -- but at what price? As a threshold matter, GTE requests that the Commission reject the FCC's definition and adopt a more reasonable definition that is consistent with the Act. Specifically, GTE believes that "technical feasibility" must be defined with regard to an incumbent LEC's ***existing*** network, and not some hypothetical network that can be built only after significant costs are incurred -- ironically, costs which MCI would force upon GTE and its customers.

Conclusion

In determining the appropriate price for the sale of unbundled elements or resold services, the Commission must provide to GTE the recovery of at least all of its historic and forward-looking costs of unbundled elements or resold services plus a reasonable

profit. If the Act were interpreted to provide anything less, then it would effect a taking of GTE's property without just compensation in violation of the Constitution.

MCI's principal goal in this proceeding is to acquire GTE's network and services at a rate well below GTE's costs. MCI also seeks to force GTE and its customers to incur costs exceeding hundreds of millions of dollars so that MCI can have its own local network without having to pay for it. In short, MCI wants GTE and its customers to subsidize MCI's foray into the local telecommunications marketplace.

MCI should not be allowed to twist the Act to promote its own interests at the expense of everyone else, and the Constitution prohibits MCI from doing so. To ensure that the purposes of the Act are met, GTE respectfully requests that the Commission do two things: First, the Commission should refuse to adopt the FCC's arbitrary default rates or any rates that are not based on GTE's own costs. Second, the Commission should establish pricing methodologies and cost recovery mechanisms that will ensure MCI pays its own way for its entry into the local telecommunications market.

GTE's proposals -- especially its M-ECPR pricing methodology -- properly balance the interests of the parties and the public with the letter and spirit of the Act. Accordingly, GTE respectfully requests that this Commission adopt GTE's proposals.

Respectfully submitted on September 20, 1996.

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TAB 2

TAKINGS REPORT

Introduction

In determining the appropriate price for the sale of unbundled elements or the resale of services by GTE Florida Incorporated ("GTE") in response to MCI's Arbitration Petition (dated August 26, 1996) ("MCI Petition"), the Florida Public Service Commission (the "Commission") must interpret the federal Telecommunications Act of 1996 (the "Act" or "1996 Act") to provide for the recovery of at least all of GTE's historic and forward- looking costs of unbundled elements or resold services plus a reasonable profit. As we demonstrate below, if the Act were interpreted to require GTE to sell unbundled elements or resell services at prices that do not cover all of GTE's costs associated with those elements or services, then the Act would effect a taking of GTE's property without just compensation, in violation of the Fifth and Fourteenth Amendments of the U.S. Constitution, as well as Article 10, Section 6 and Article 1, Section 9 of the Florida Constitution.

Under familiar principles of statutory construction, such an interpretation must be avoided because the Commission must read the Act to avoid serious constitutional questions. See, e.g., Rust v. Sullivan, 500 U.S. 173, 190-91 (1991); Ashwander v. Tennessee Valley Authority, 297 U.S. 288, 347 (1936) (Brandeis, J., concurring). Indeed, in the specific context of takings, the Supreme Court has admonished that if an "identifiable class of cases [exists] in which application of a statute will necessarily constitute a taking," then concerns for avoiding uncompensated takings properly require a narrowing construction of the statute. United States v. Riverside Bayview Homes, Inc., 474 U.S. 121, 128 n.5 (1985).

As we demonstrate below, under either a regulatory takings or physical occupation analysis, the Act would effect an unconstitutional taking if it were interpreted to require GTE to sell its elements or services below their true costs to MCI or to any competitive local exchange carrier ("CLEC"). Thus, to avoid constitutional infirmity, the Commission must read the Act to require prices that cover all of GTE's costs plus a reasonable profit. In the specific context of this arbitration, that principle requires at least two things:

First, at a minimum, the prices set for unbundled elements or resold services must cover at least the following five elements, which comprise GTE's true forward-looking costs:

(i) **Incremental Costs.** The prices set must cover GTE's total element long-run incremental cost of providing that service ("TELRIC"). Moreover, the principle that all of GTE's true costs must be recovered requires that TELRIC be calculated based on GTE's actual network architecture, not on some hypothetical, more efficient network that could now be constructed.

(ii) **Joint And Common Costs.** The principle that GTE must be allowed to recover all its costs further requires that prices be set to allow GTE to recover all of its forward-looking joint and common costs, not just a portion of those costs. Any pricing rule that denies GTE recovery for all its joint and common costs, or provides for the recovery of only a portion of those costs, necessarily requires GTE to sell below its true costs and thereby would effect an uncompensated and unconstitutional taking.

(iii) **Cost of Subsidies.** To the extent that the current price of an unbundled element or a resold service contains a subsidy, or "contribution" towards either the cost of the provision of a service that Florida requires GTE to provide at regulated prices that are below cost or the cost incurred as a result of incumbent burdens that GTE continues to bear after the advent of competition, then GTE must recover its costs unless and until Florida allows GTE to rebalance its rates or eliminates the mandated subsidy.

(iv) **Costs of Unbundling or Resale.** Any price set under the Act must include any additional costs incurred to accomplish unbundling or resale.

(v) **No Overstated Avoided Costs.** With respect to resold services, GTE cannot be required to resell services below their true costs (considering all other elements listed here) or with a discount that exceeds GTE's truly avoided costs.

Second, even if the Commission were to allow GTE a recovery of its forward-looking incremental costs plus a reasonable profit, GTE still must be allowed to recover any portion of its historical costs not yet recovered and to earn a fair rate of return on that investment. Accordingly, the Commission must provide for some mechanism -- such as an end-user charge or surcharge -- by which GTE recovers the difference between the reasonable return that it was promised on its historical, embedded costs and what it will now receive under a regime of competition. For GTE, the transition from regulation to competition means that its market will be opened up to competition yet it will be saddled with the heavy costs of an incumbent local exchange carrier (like universal service and carrier of last resort), while its competitors will not

only be free of those burdens but will also be allowed to purchase or lease GTE's services or network elements at heavily discounted prices -- which GTE itself will subsidize. The Takings Clause requires that GTE be allowed to recover the substantial investments it made under a regulated-monopoly regime in which the Commission promised GTE that it would be able to recover and earn a fair rate of return on its investments.

Discussion

I. THIS COMMISSION IS NOT BOUND BY THE FCC'S PRICING RULES.

As a predicate matter, it is important to point out that the Commission is not bound by the pricing rules set in the Federal Communications Commission's ("FCC's") First Report and Order for two wholly independent reasons.[1] First, the FCC had no statutory authority to set the pricing rules and default prices it did (see Part I.A below). Second, even if it did, the prices it did set would work an unconstitutional taking. (See Part II.B.) In either case, the Commission is not bound to follow the FCC's prices. Indeed, the Commission is under a statutory duty to interpret the Act for itself and a constitutional duty to ensure that GTE receives just compensation for opening up its network to unbundling and resale.

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[1] In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, CC Docket 96-98, CC Docket 95-185, FCC 96-325 (released Aug. 8, 1996) ('First Report and Order") ¶¶ 618-984.

A. The FCC Lacks Authority To Promulgate National Pricing Standards Governing Agreements Under Section 251 of the Act.

The FCC's attempt to set national pricing standards to govern interconnection, unbundling, and resale agreements negotiated under Sections 251 and 252 of the Act is inconsistent with Congress' scheme to have the States (through arbitrations) and private parties (through negotiations) establish prices. It is clear -- both under the Act and under Section 2(b) of the Communications Act of 1934 -- that the FCC lacks the power to promulgate national pricing standards. See 47 U.S.C. § 152(d).

1. Only The Commission Was Granted Pricing Authority.

In the event that the parties to a negotiation cannot agree on the price for interconnection, unbundled access or resale, the Act expressly assigns to State commissions, not the FCC, the power to determine those prices through the arbitration process. Section 252(c)(2) provides, in terms that could not be clearer, that "a State Commission shall . . . establish any rates for interconnection, services, or network elements according to subsection (d)." 47 U.S.C. § 252(c)(2) (emphasis added). Subsection (d)(1) then goes on to provide that "[d]eterminations by a State commission of the just and reasonable rate for . . . interconnection . . . and [access to unbundled] network elements" shall be based on "cost" and "may include a reasonable profit." 47 U.S.C. § 252(d)(1) (emphasis added). Similarly, subsection (d)(3), governing resale, expressly provides that "a State Commission shall determine wholesale rates . . . ." 47 U.S.C. § 252(d)(3) (emphasis added). These sections, in unambiguous terms, assign

to the State commissions -- not the FCC -- the power to set prices for interconnection, unbundling, and resale.

If the explicit statutory text assigning the power to determine prices to State commissions were not clear enough, then the structure of the Act makes the point even clearer. Section 252(c)(1) provides, generally, that in imposing conditions on the parties to a negotiation, a State commission shall ensure that such conditions meet the requirements of both "section 251" and "the regulations . . . prescribed by the [FCC] pursuant to section 251." 47 U.S.C. § 252(c)(1). By contrast, the very next subsection -- § 252(c)(2), which governs pricing -- provides that a State commission shall establish rates for interconnection and unbundling "pursuant to subsection (d)." 47 U.S.C. § 252(c)(2). There is no mention of any FCC regulations on pricing issues. Thus, where Congress wanted the State commissions to follow the FCC's regulations (§ 252(c)(1)), it said so explicitly; by contrast, with respect to setting prices, Congress expressly omitted any reference to regulations by the FCC, and referred instead only to the substantive requirements imposed on the State commissions by § 251(d) in determining prices.

2. The FCC Has No Pricing Authority.

The textual basis relied on by the FCC to assert jurisdiction to determine prices only highlights the weakness of its position. The FCC concedes that "we recognize that these sections [§§ 251 and 252] do *not* contain an explicit grant of intrastate authority to the [FCC]." First Report and Order ¶ 84 (emphasis added). The FCC finds purported textual authority to determine prices in the directive in § 251(d)(1) stating that "[w]ithin 6 months after the date of enactment of th[is Act], the [FCC] shall

complete all actions necessary to establish regulations to implement the requirements of this section." 47 U.S.C. § 251(d)(1).

It is quite unreasonable for the FCC to rely on § 251(d)(1) as granting the FCC authority to determine prices. First, that section has nothing to do with granting the FCC the authority to do anything. It merely sets time deadlines for those tasks the FCC is otherwise given under the Act. Indeed, Section 251(d)(1) is a limitation on the FCC -- requiring it to act within sixth months -- not a grant of authority. Second, to the extent that § 251(d)(1) impliedly grants the FCC authority to issue regulations, it does so only with respect to certain specific tasks expressly assigned to it by the Act. It is not a general grant of authority for the FCC to establish prices. Thus, for example, § 251(e)(1) expressly directs the FCC to "create or designate one or more impartial entities to administer telecommunications numbering." 47 U.S.C. § 251(e). That obviously has nothing to do with pricing.[2]

Section 2(b) of the Communications Act of 1934 (codified at 47 U.S.C. § 152(b)) provides that "nothing in this chapter shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." The Supreme Court has held that this "congressional denial of power to the FCC" over

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[2] If anything, § 251(d) **confirms** by implication that the FCC has no authority under the Act to determine the prices for interconnection, unbundling and resale. That is so because § 251(d)(2), while expressly articulating the substantive standards to govern the FCC's power to determine which network elements to unbundle, omits any reference to any substantive standards to govern the determining of pricing. 47 U.S.C. § 251(d)(2). Rather, the only place those substantive standards -- governing pricing -- are found are in § 252(d)(1), which expressly refers to the substantive standards governing the State commissions' determination of prices. 47 U.S.C. § 252(d)(1).

prices and other matters regarding the provision of local telephone service can be overcome only if Congress includes "unambiguous" and "straightforward" language in the Act either modifying § 2(b) or expressly granting the FCC additional authority. See Louisiana Pub. Serv. Comm'n v. FCC, 476 U.S. 355, 374, 377 (1986).

Obviously, neither exception to § 2(b) is present here. Whatever else can be said of § 251(d)(1), it cannot be said that that section "unambiguously" or "straightforwardly" gives the FCC the authority to set the prices for interconnection and unbundling of the local telephone network or resale of local telephone service. Similarly, no provision in the 1996 Act expressly modifies § 2(b) in granting to the FCC authority to regulate either prices or other local matters under § 251. To the contrary, such a provision **was expressly rejected by Congress**, for while it was included in the Senate bill, it was not included in the law as enacted. See Conf. Rep. No. 458, 104th Cong., 1st Sess. § 101(c) (1996). Indeed, even the FCC concedes that no provision of the 1996 Act "contain[s] an explicit grant of intrastate authority to the [FCC] . . . ." First Report and Order, ¶ 84.

In response to this fatal § 2(b) problem, the FCC contends that the 1996 Act supposedly "moves beyond the distinction between interstate and intrastate matters that was established by the 1934 Act" and that section 251 "should take precedence" over any "contrary implications" in § 2(b). First Report and Order ¶¶ 24, 83, 93. But that "reasoning" is plainly flawed on a number of different levels.

Most notably, there is simply no grant of authority over prices in § 251 to "take precedence" over the rule of § 2(b). In addition, the Supreme Court could not have been more clear that § 2(b) deprives the FCC of jursidiction over intrastate

communications services unless some later act expressly modifies § 2(b) or expressly grants the FCC power over intrastate communications services. See Louisiana Pub. Serv. Comm'n, 476 U.S. 355. The FCC's general "sense" that the 1996 Act impliedly "moves beyond the distinction between interstate and intrastate matters established by [§ 2(b)]" cannot overrule the explicit "congressional denial of power to the FCC" in § 2(b).

* * *

In sum, the plain language of the Act, the structure of the Act, the rule of construction specified by Congress in Section 2(b), and important policy concerns all demonstrate that the FCC has no authority to set the prices for interconnection, unbundling, and resale. That task is plainly and unequivocally given to the Florida Commission.

B. Even If The FCC Had The Authority To Set Prices, Both Its Pricing Methodology And Its Default Proxy Rates, If Followed, Would Effect A Taking.

1. The FCC's Pricing Methodologies Would Effect A Taking.

Even if the FCC had the authority to set prices (which it does not), the standards it has chosen are an impermissible interpretation of the Act because they would not compensate GTE fully for its true costs. As we demonstrate below (Parts II-III), the FCC's pricing methodology is defective for a variety of reasons. Principally, though, it fails to allow GTE full recovery of its historic costs and fails to allow GTE its full measure of joint and common costs on a forward-looking basis. Both aspects of the FCC's defective pricing methodology only underscore why anything less than full

recovery of GTE's costs, as discussed in more detail in Report VIII, would effect an unconstitutional taking without just compensation.

2. The FCC's Default Proxy Rates For Unbundling, Interconnection And Resale Are Procedurally Defective And Effect A Taking.

The FCC also erred in several respects in establishing the default proxy prices for interconnection, unbundled elements, and resale under the Act. See First Report and Order ¶¶ 767, 932. First, the FCC erred by circumventing the congressionally designed State-sponsored arbitration process by establishing default prices through a rulemaking -- and an abbreviated rulemaking at that. By design, the arbitration process was intended by Congress to allow the Commission to engage in the fact-specific decision making tied to the circumstances of each case. By attempting to arrive at default proxy rates through a rulemaking, the FCC usurped the role of the Commission and deprived parties of the fact-specific adjudicative process contemplated under the Act, violating both the Administrative Procedure Act and the Due Process Clause of the Constitution.

Further, the default proxy rates established by the FCC for interconnection and unbundled elements are defective because they are not only inconsistent with the FCC's own flawed pricing methodology but they also effect an unconstitutional taking. As we show in Report VIII, the FCC's proposed proxy rates fall well below the minimum that GTE must recover for resale and unbundled elements in order to recover its true costs and avoid an unconstitutional taking without just compensation.

In short, under the Act, the Commission -- not the FCC -- has the right and obligation to set the prices for unbundled elements and resold services. Moreover, the Commission is bound to read the Act in a manner that avoids constitutional infirmity, and it need not follow an interpretation by the FCC that raises such constitutional difficulties. Thus, the Commission should determine on its own what pricing rule the Act and the Constitution require without reference to the FCC's First Report and Order.[3]

II. THE TAKINGS CLAUSE PROHIBITS GTE FROM BEING REQUIRED TO SELL ELEMENTS OR SERVICES BELOW THEIR TRUE COSTS.

Whether MCI's Petition is analyzed as a regulatory takings issue because its proposed rates would be confiscatory and, therefore, unconstitutional (see Part II.A below) or as a physical per se taking because MCI's Petition proposes a physical occupation of GTE's network without just compensation (see Part II.B below), the result is the same: The Fifth and Fourteenth Amendments simply prohibit Congress and the States from requiring GTE to sell elements or services at prices that do not cover all of their true costs, plus a reasonable profit.

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[3] On August 28, 1996, GTE sought a stay from the FCC of its Report and Order pending judicial review and requested that the FCC act on GTE's motion within 10 days. If the FCC has not acted within that time, GTE intends to seek a stay from a federal Court of Appeals.

A. Regulatory Takings Analysis.

1. Regulators Cannot Force a Business to Operate at a Loss.

The Supreme Court's Brooks-Scanlon decision long ago established the rule that the Takings Clause of the U.S. Constitution forbids a regulator from forcing a utility to operate a segment of its business at a loss because the firm happens to be profitable elsewhere in another segment of its business. Brooks-Scanlon Co. v. Railroad Comm'n of Louisiana, 251 U.S. 396, 399 (1920). The Supreme Court concluded that

> [a] carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage . . . . The plaintiff may be making money from its sawmill and lumber business but it no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others who do not care to pay for it.

Brooks-Scanlon stands for the proposition that the Commission may not force a regulated entity to provide a regulated service below cost without providing compensation. See also Northern Pac. Ry. Co. v. North Dakota, 236 U.S. 585, 595 (1915) (to same effect, noting that "[t]he fact that the property is devoted to a public use on certain terms does not justify the requirement that it shall be devoted to other public purposes").[4]

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[4] Many courts have reaffirmed Brooks-Scanlon's rule that a railroad may not be required to operate part of its business at a loss. See, e.g., Railroad Commission of Texas v. Eastern Texas R.R. Co., 264 U.S. 79, 85 (1924) (state regulators cannot require continued operation of railroad line at a loss); Bullock v. Florida, 254 U.S. 513, 520-21 (1921) (same); National Wildlife Fed'n v. ICC, 850 F.2d 694, 707 (D.C. Cir. 1988) (reaffirming "general rule" set forth by Brooks-Scanlon and Bullock that "[a] carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage"); Gibbons v. United States, 660 F.2d 1227, 1233

(continued...)

It is no answer to the Brooks-Scanlon principle that the firm may have an overall rate of return that covers its costs based on sales of other services. In Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989), the Supreme Court carved out an exception to Brooks-Scanlon along those very lines, but that exception has no application here. Duquesne suggests that all that matters for purposes of the Takings Clause is the net effect of regulation on the enterprise. Duquesne involved two utilities that challenged a state statute prohibiting a utility from recovering in its rates an investment that was not used and useful. The $35 million investment at issue in Duquesne reduced the rate base for one of the utilities by 1.9% and reduced its revenue by 0.4%; for the other, it reduced the utility's rate base by 2.4% and its revenue by 0.5%. The Court reasoned that there was a negligible effect on the overall financial status of both utilities. The Court thus focused not on any one aspect of an order, but rather on the overall effect of regulation on the enterprise:

> Errors to the detriment of one party may well be canceled out by countervailing errors or allowances in another part of the rate proceeding.

(...continued)
(7th Cir. 1981) ("Brooks-Scanlon and Bullock define the basic limitations upon a modern railroad's public service obligation in the face of financial loss. . . . The constitutional principle embodied in these decisions retains its vitality; a railroad cannot be compelled to continue unprofitable operations indefinitely") (citation omitted); In re New York, New Haven & Hartford R.R., 304 F. Supp. 793, 804 (D. Conn. 1969) ("This court . . . concludes that Brooks-Scanlon and subsequent cases, reaffirming the validity of its holding, are still applicable and determinative."), aff'd in part, vacated in part, 399 U.S. 392 (1970); New York, New Haven & Hartford R.R. v. United States, 289 F. Supp. 418, 440-41 (S.D.N.Y. 1968) (3-judge court) (Friendly, J.) ("We see no reason to question the validity of Justice Holmes' decision in [Brooks-Scanlon] . . . forbidding the State of Louisiana to require a railroad to continue its deficit operation with no hope for profits in the foreseeable future."), vacated, 399 U.S. 392 (1970) (citation omitted).

> The Constitution protects the utility from the net effect of the rate order on its property.

Id. at 314. The Duquesne Court also made clear that there would have been a taking if the allowed rates had been "inadequate to compensate current equity holders for the risk associated with their investments under a modified prudent investment scheme." Id. at 312.[5]

The central insight in Duquesne was that there was no need to analyze closely the method used by the regulator as long as it passed constitutional scrutiny by allowing the firm to earn a competitive rate of return on invested capital. **But, the premise of the decision -- which distinguishes it from Brooks-Scanlon -- was that the regulator could and did insulate the regulated utility from competition and thus guarantee a constitutionally acceptable outcome.** Thus, to the extent that the "end-result" test of Duquesne suggests that a regulator could force a utility to operate one segment at a loss, that reasoning has no application here. It may well be that GTE is still subject to "regulation" by the Commission, but that no longer means what it once did in a regulated monopoly regime. Now, under competition, GTE no longer is insulated from the competitive forces of the marketplace. This has nothing to do with whether competition, as a normative matter, is the best policy. It simply means that

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[5] See also Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591, 603 (1944) ("[R]eturn to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks."); Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679, 692-93 (1923) ("A public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risk and uncertainties").

MCI cannot rely on the exception in Duquesne to justify the Commission setting insufficient rates for resale, unbundled elements, and interconnection on the theory that GTE may be profitable elsewhere in its system. For these reasons, the Brooks-Scanlon rule governs this case, and the Commission cannot force GTE to operate any segment of its business at a loss.

2. The Commission Must Ensure GTE A Fair Rate of Return.

Whether the Brooks-Scanlon or Duquesne model applies, a regulator must ensure the utility a fair, non-confiscatory rate of return. That requires a utility's investors to earn a return that is commensurate with investments having a similar risk. As the Supreme Court concluded in Federal Power Commission v. Hope Natural Gas Co., 320 U.S. 591 (1944):

> From the investor or company point of view it is important that there be enough revenue not only for operating expenses but also for the capital costs of the business. These include service on the debt and dividends on the stock. By that standard the return to the equity owner should be commensurate with returns on investments in other enterprises having corresponding risks. That return, moreover, should be sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital.

320 U.S. at 603 (emphasis added).

In Duquesne, as explained above, the Court reaffirmed that "the return investors expect given the risk of the enterprise" is always relevant to the constitutional adequacy of a rate. Duquesne, 488 U.S. at 314. In support of this point, the Court quoted with approval from its opinion in Bluefield Water Works & Improvement Co. v. Pub. Serv. Comm'n, 262 U.S. 679 (1923), which held that a utility is entitled to rates that will enable it to earn a return '"equal to that generally being made at the same time

and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties.'" Id. at 314-15 (quoting Bluefield Water Works, 262 U.S. at 692).[6] Thus, pursuant to the Takings Clause, the Commission must interpret the Act to allow GTE sufficient recovery of its invested capital to maintain its credit, to attract capital, and to ensure a return that will be commensurate with investments of a similar risk. See also Tenoco Oil Co. v. Department of Consumer Affairs, 876 F.2d 1013, 1020 (1st Cir. 1989) ("To be just and reasonable, rates must provide not only for a company's costs, but also for a fair return on investment. Rates which fall below this standard are 'confiscatory'") (citation omitted), aff'd, 60 F.3d 864 (1st Cir. 1995); Medical Malpractice Joint Underwriting Ass'n v. Paradis, 756 F. Supp. 669, 676 (D.R.I. 1991) (holding unconstitutional an insurance rate that would have caused insurance companies to incur a loss).

It has also long been required that just compensation for a taking requires that the property owner be put in the same position as he would have been if the exchange had been voluntary -- as opposed to involuntary (as here). Consistent with this principle, courts have held that the owner is "to be put in as good a position pecuniarily as if his property had not been taken." Olson v. United States, 292 U.S. 246, 255 (1934); see also United States v. Reynolds, 397 U.S. 14, 16 (1970);

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[6] See also Illinois Bell Tel. Co. v. FCC, 988 F.2d 1254, 1263(D.C. Cir. 1993) (test to be applied in evaluating a rate order is "whether the 'end result' meets the Hope standards: attraction of capital and compensation for risk"); Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1178, 1181 (D.C. Cir. 1987) (en banc) (utility's inability to pay dividends to common shareholders supported contention that FERC's rates were confiscatory) (citing Permian Basin Area Rate Cases, 390 U.S. 747, 792, 812 (1968)).

Hedstrom Lumber Co. v. United States, 7 Cl. Ct. 16, 27 (1984) (citing Foster v. United States, 2 Cl. Ct. 426, 445 (1983)) (to same effect); see generally Richard A. Epstein, Takings: Private Property And The Power Of Eminent Domain 182 (Harvard University Press 1985) ("In principle the ideal solution is to leave the individual owner in a position of indifference between the taking by the government and retention of the property").[7]

Applying these takings principles here requires that GTE recover its full joint and common forward-looking costs as well as its historic costs. Anything less would jeopardize GTE's ability to continue attracting capital, would not afford its investors a return commensurate with the risk of similar investments, and would fail to place GTE in the position it would have been had its property not been taken through confiscatory pricing.

B. Physical Occupation Analysis.

The Commission must set prices for unbundled elements and resold services that allows GTE a recovery of its true costs and reasonable profit for yet another wholly independent but related reason. MCI's proposals would amount to a per se taking by physical occupation of various parts of GTE's network.

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[7] See also Yancey v. United States, 915 F.2d 1534, 1542 (Fed. Cir. 1990) ("the fair market value of property under the Fifth Amendment can include an assessment of the property's capacity to produce future income if a reasonable buyer would consider that capacity in negotiating a fair price for the property"); Cloverport Sand & Gravel Co. v. United States, 6 Cl. Ct. 178, 188 (1984) (fair market value has been defined as the amount a "willing buyer would agree to pay a willing seller in cash, with neither party being under a compulsion to buy or sell"). Accord United States v. New River Collieries Co., 262 U.S. 341, 343 (1923); Seaboard Air Line Ry. v. United States, 261 U.S. 299, 304 (1923).

In Loretto v. Teleprompter Manhattan CATV Corp., 458 U.S. 419 (1982), the Supreme Court held that a New York law requiring a landlord to permit installation of cable television equipment on rental property was a constitutionally compensable taking. The Court held that, while "no 'set formula' existed to determine, in all cases, whether [government regulation of private property constitutes a taking]," where the government authorizes a permanent physical occupation of one's property by a third party, a taking is determinatively established. Id. at 426. The Court held that the law at issue in Loretto plainly amounted to a taking by a physical occupation because the "installation involved a direct physical attachment of" the cable company's equipment to the owner's property. Id. at 438.

The Supreme Court revisited the application of takings principles by permanent physical occupation to highly regulated industries in FCC v. Florida Power Corp., 480 U.S. 245 (1987). In that case, a utility company challenged on takings grounds the provisions of the Pole Attachments Act that authorized the FCC to set the rates that utility companies could charge cable television companies for using their utility poles for stringing television cable. The Court held that

> Loretto ha[d] no applications to the facts of [Florida Power -- and there was no taking by physical occupation -- because while] the statute we considered in Loretto specifically required landlords to permit permanent occupation of their property by cable companies, nothing in the Pole Attachments Act as interpreted by the FCC . . . gives cable companies any right to occupy space on utility poles, or prohibits utility companies from refusing to enter into attachment agreements with cable operators.

Id. at 250-51 (emphasis added).

In other words, where, as in Florida Power, the property owner voluntarily invites the third party onto its property (by lease or otherwise), there is no permanent

physical occupation mandated by the government and hence no taking for that reason, and the government is free to regulate the terms of the lease or other invitation (i.e., regulate the use of the property) without effecting a per se taking by physical occupation. Or, as the Supreme Court put it, the "element of required acquiescence is at the heart of the concept of [per se taking by physical] occupation." Id. at 252. See also Yee v. Escondido, 503 U.S. 519, 527 (1992) ("required acquiescence is at the heart of the concept of [taking by physical] occupation").

Florida courts have explicitly recognized the principles laid down by the U.S. Supreme Court. See, e.g., Storer Cable T.V. of Florida, Inc. v. Summerwinds Apartments Associates, Ltd., 493 So. 2d 417 (1986); Beattie et al. v. Shelter Properties, 457 So. 2d 1110 (Fla. 1st DCA 1984).

Applying these well-settled principles here, it is plain that the obligations imposed on GTE under section 251 -- collocation, unbundled network access to the local loop, pole attachments, and access to GTE databases -- constitute a taking by permanent physical occupation.

1. **Physical Collocation.**

MCI has requested physical collocation. (MCI Petition at 8). As described in the testimony of GTE witness Ries, physical collocation allows a CLEC to place certain equipment necessary for interconnection in a dedicated space at the facility of an incumbent local exchange carrier ("ILEC"), like GTE. See 47 U.S.C. §251(c)(6); First Report and Order ¶¶ 555-607. The Act obligates ILECs to allow for the physical occupation by the CLEC to establish a mini-facility on the property of the

ILEC for an indefinite period with the further right to enter the ILEC's facility to install, maintain, and repair collocated equipment, as it deems necessary.

Physical collocation amounts to an installment and direct physical attachment to GTE's property. Cf. Loretto, 458 U.S. at 438. There is no question that a third party -- as opposed to GTE -- would have an exclusive property interest in the space on GTE's premises. See Id. at 440 n.19. And there is no question that, unlike in Florida Power and Yee, the Act requires an ILEC to allow third parties to physically occupy their premises. Thus, this case falls squarely within the per se takings rule of Loretto, as clarified in Florida Power and Yee.

The collocation issue has been squarely addressed by the Oregon Supreme Court, which held that physical collocation amounts to a taking by permanent physical invasion. In GTE Northwest Inc. v. Public Util. Comm'n of Oregon, 321 Ore. 458, 468-77, 900 P.2d 495, 501-06 (1995), cert. denied, 116 S.Ct. 1541 (1996), the Supreme Court of Oregon held that state-mandated collocation rules effected an unconstitutional physical taking. Id. The Court reasoned that when the government requires a physical intrusion into one's property that reaches the extreme form of a permanent physical occupation, a taking has occurred. Id.[8]

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[8] The one federal court to address this issue has agreed that physical collocation "would seem necessarily to 'take' property regardless of the public interests served in a particular case." Bell Atlantic Tel. Cos. v. FCC, 24 F.3d 1441, 1446 (D.C. Cir. 1994). The D.C. Circuit did not, however, have to reach the taking issue because that court concluded that the FCC did not have the statutory authority to order physical collocation.

2. Unbundled Access To The Local Loop.

MCI has requested access to the local loop on an unbundled basis. (MCI Petition at 13, 19-23.) The Act provides CLECs with the right to unbundled access to the local loop. 47 U.S.C. § 251(c)(3); First Report and Order ¶¶ 226-541. As described in GTE witness Wood's testimony, GTE is forced to transfer a property interest in the loop to MCI. That interest is more akin to a forced lease than a sale. If a customer who elects MCI as a local telephone provider decides to switch back to GTE, then GTE would again assume the property interest given to MCI. Once MCI or any other CLEC assumes an interest in the local loop, however, GTE cannot provide local exchange or any other service over that wire.

The physical occupation here is very similar to the taking in physical collocation. Here, GTE's turning over of the local loop to MCI -- by compulsion from the government -- amounts to a direct physical occupation of its property by a third party, as it did in Loretto. 458 U.S. at 438. Nor is there a question that GTE owns this property. See id. at 440 n.19. And there is no question that, unlike in Florida Power and Yee, the Act requires GTE to allow MCI and other third parties to physically occupy its premises. This case, just like physical collocation, falls squarely within the per se takings rule of Loretto, as clarified in Florida Power and Yee.

3. Access To Poles, Ducts, Conduits & Rights Of Way.

MCI has requested access to GTE's poles, ducts, conduits and rights of way. (MCI Petition at 43.) As described in the testimony of GTE witness Bailey, under Section 224, as amended by the Act, utilities are required to provide non-discriminatory

access to any pole, duct, conduit, or right-of-way owned or controlled by a utility. 47 U.S.C. § 224 (1996). The FCC has interpreted Section 224 as requiring mandatory access to GTE's facilities. First Report and Order ¶¶ 1119-1240.

After Florida Power, there can be no question that forced access to poles is also a per se physical taking. The only issue left open in Florida Power was whether there had been a forced occupation. The Supreme Court made clear that the distinguishing factor in Florida Power was that unlike the forced access in Loretto, "nothing in the Pole Attachments Act as interpreted by the FCC in these cases gives cable companies any right to occupy space on utility poles, or prohibits utility companies from refusing to enter into attachment agreements with cable operators." 480 U.S. at 251. This distinguishing factor has been eliminated by the Act and the First Report and Order, which undoubtedly require forced access to poles and thus effect a taking.

4. Databases.

MCI has requested access to GTE's databases. (MCI Petition at 21-22, 25.) As described in the respective testimony of GTE witnesses Morris, DellAngelo, and Langley, GTE has a protected property interest in its databases, yet MCI's proposal would allow it to obtain forced access to GTE's intellectual property. That too would constitute a taking.

There can be no question that GTE's intellectual property -- if taken without just compensation -- would constitute a taking. Rights in computer software and computer hardware are "property" protected against uncompensated takings under the Takings Clause of the Fifth Amendment. Whether the nature of the property is the

ownership of the tangible product itself, the intangible interest in the underlying data, the patent, copyright, trade secret rights, or any contractual right relating to the use of the software, each is independently protected by the Takings Clause. For example, in Ruckelshaus v. Monsanto Co., 467 U.S. 993 (1984), in which the Court held that property interests in trade secrets constituted compensable property for purposes of the Takings Clause, the Court observed:

> This general perception of trade secrets as property is consonant with a notion of "property" that extends beyond land and tangible goods and includes the products of an individual's "labour and invention." Although this Court never has squarely addressed the question whether a person can have a property interest in a trade secret, which is admittedly intangible, the Court has found other kinds of intangible interests to be property for purposes of the Fifth Amendment's Taking Clause . . . That intangible property rights . . . are deserving of the protection of the Taking Clause has long been implicit in the thinking of this Court[.]

Id. at 1003 (citations omitted); see also Lynch v. United States, 292 U.S. 571 (1934) (valid contracts are property within meaning of the Takings Clause).[9]

* * *

It is no response to the various physical takings here that somehow GTE's interest in its real property (facilities, network, poles, ducts, or conduits) or in its intellectual property (databases) should be accorded any less respect because GTE's local telephone exchange business has been regulated by the Commission. A long line

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[9] See also Leesona Corp. v. United States, 599 F.2d 958 (Ct. Cl. 1979) (where government infringed patent, it was deemed to have "taken" the patent license under an eminent domain theory and entitled to just compensation under the Fifth Amendment), cert. denied, 444 U.S. 991 (1979); Ladd v. Law & Technology Press, 762 F.2d 809, 813 (9th Cir. 1985) (observing that copyrighted materials constituted private property for purposes of the Takings Clause), cert. denied, 475 U.S. 1045 (1986).

of cases establishes that a utility's property -- even though subject to regulation -- remains the property of the utility, not the government. See Munn v. Illinois, 94 U.S. 113, 126 (1877); Delaware, L. & W. R.R. v. Morristown, 276 U.S. 182, 193 (1928); Northern Pac. Ry. v. North Dakota, 236 U.S. 585, 595 (1915). Therefore, regulation by the Commission may alter the use of property, but it cannot alter the underlying ownership of the property for purposes of a physical taking.

Put another way, there is nothing about the relationship between GTE, as a regulated entity, and the Commission that suggests that GTE has in any way bargained away its private property rights in exchange for a franchise that it has enjoyed up until now in the local exchange market in its service territory. MCI has provided no evidence -- and it will be unable to provide any evidence -- of any agreement by GTE to give up its private property rights in its network facilities. The only bargain that GTE has entered into has been to provide quality universal telephone service to the customers of Florida in exchange for an exclusive franchise that would allow for a recovery of and a fair rate of return on its invested capital. Never has GTE turned over any part of its property rights to the State.

To the contrary, GTE has preserved all the traditional incidents of private ownership of its network property -- including title, possession, and the right and obligation to incur debt to finance that property, to depreciate it, and to pay taxes on it. Any suggestion that GTE does not have a full property interest in its property would be news to state and federal taxing authorities, to GTE's creditors, and to its shareholders.

Therefore, GTE is entitled to just compensation for the physical occupation and taking of its property. While recovery of the fair market value is

typically the measure of just compensation for a taking, see, e.g., United States v. 564.54 Acres of Land, 441 U.S. 506, 515-17 (1979), the Supreme Court has long recognized that there is no "rigid rule" requiring that standard. United States v. Commodities Trading Corp., 339 U.S. 121, 123 (1950). Thus, where a "market value", as here, would be "difficult to find," other standards may be appropriate. Again, the guiding principle is that the property owner should be put in "as good a position pecuniarily as if his property had not been taken." Olson, 292 U.S. at 255. Here, that means allowing GTE all of its forward looking costs pursuant to the "market-determined efficient component pricing rule" ("M-ECPR") (as discussed in greater detail in Part III.A below) and a recovery of and a fair rate of return on its historic costs of creating the network that has been taken (Part III.C below). Here, the measure of just compensation for a physical taking is no different from the compensation owed GTE under the regulatory/confiscatory pricing analysis discussed above (Part II.A).

III. GTE MUST RECOVER ALL ITS FORWARD-LOOKING COSTS AND EARN A FAIR RATE OF RETURN ON ITS HISTORIC COSTS.

In Parts I and II above, we explained how MCI's Petition would effect an unconstitutional taking and why the FCC's First Report and Order provides no safe harbor for that taking. In this Part, we apply these takings principles to this arbitration and demonstrate that GTE must recover its full forward-looking costs (Part III.A) and historic costs (Part III.B) to avoid an uncompensated and unconstitutional taking.

A. There are Five Forward-Looking Costs That GTE Must Recover.

1. Incremental Costs.

For any piece of GTE's network that is either leased or sold, it is commonly accepted that GTE is entitled to its long run incremental cost. In its First Report and Order, the FCC adopted this principle by establishing a pricing methodology for interconnection and unbundled elements based on the TELRIC of providing a particular network element plus a reasonable share of forward-looking joint and common costs. First Report and Order ¶¶ 674-703. Under MCI's pricing proposal, however, GTE would not even recover its incremental cost in some cases. (See testimony of GTE witness Sibley and associated Report.) Where GTE's incremental cost is higher than its retail rate (in the case of residential service, for example), forcing GTE to sell at "retail" would effect an unconstitutional taking in the absence of some other mechanism to make GTE whole. (Sibley testimony and Report.) That is to say, even the retail price does not fully cover GTE's incremental costs. Even worse, forcing GTE to sell at a price that is less than retail -- in the case of wholesale rates, for example -- would only make the taking more pronounced. (Id.)

2. All Forward-Looking Joint And Common Costs.

To the extent that MCI's Petition allows for GTE to receive anything less than the full recovery of all forward-looking joint and common costs for any piece of GTE's network that is either leased or sold, it would be a taking without just compensation.[10] Even the "reasonable" portion of joint and common forward-looking

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[10] A firm's "joint" costs are those costs incurred when two or more services are (continued...)

costs that would be permitted under the FCC's interpretation, however, would be insufficient. The First Report and Order suggests two permissible methods of calculating the "reasonable" portion -- both of which would subsidize MCI's entry into the market by ensuring that GTE earned only a portion of its forward-looking joint and common costs. First Report and Order ¶ 696. (Both methods are explained in more detail in Dr. Sibley's report.)

Under one method, GTE would only be entitled to a fixed markup, which would mean that GTE would be forced to forego a significant share of the contribution it otherwise would have earned. Under the other method, the FCC would "allocate" GTE's forward-looking common costs to the elements that are the most competitive and, therefore, least likely to recover their assigned costs. As explained in greater detail in the Report submitted by Dr. Sibley, both methods would foreclose the possibility that GTE would be able to achieve the recovery of forward-looking costs that the FCC purports to endorse, and would effect an unconstitutional taking without just compensation. MCI has failed to explain how this basic constitutional defect would be rectified.

MCI's pricing proposal appears to be based on the erroneous proposition that joint and common costs are de minimis in the provision of local telephone service. MCI has -- once again -- offered no evidence to support this claim.

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[10](...continued)
produced in fixed proportion. A firm's "common" costs are those costs incurred in the provision of some or all the firm's services that are not incremental to any individual service. Common costs can only be "avoided" by shutting down the entire firm or by not producing a particular group of services under review. (See Sibley Report.)

3. GTE's Costs Of Subsidizing Other Services.

It has long been a fundamental tenet of regulation of local telephone service that the incumbent LEC bears certain burdens -- notably, rate structures that reflect cross subsidies from universal service and carrier of last resort obligations. These burdens, unique to the incumbent, come at a tremendous cost. GTE has explained elsewhere in its submission (Sibley testimony and Report) that these costs are certain and quantifiable. To the extent that the Commission would force the incumbent to bear these costs, that would constitute an uncompensated, unconstitutional taking.

The cost of the subsidy, or "contribution" is particularly severe when considering the sale or lease of an unbundled element (the local loop, for example). If the price of the loop is set too low, then GTE will not recover its full costs associated with the loop, as discussed in greater detail Dr. Sibley's Report. But even worse, GTE will also lose the opportunity to sell other higher-margin services that provide contribution toward universal service and carrier of last resort obligations. So, when GTE sells/leases an unbundled loop to MCI, for example, MCI will likely self-provision the switching facilities necessary to provide higher-margin vertical services. Yet these are precisely the higher-margin vertical services that provide contribution to GTE's costs that traditionally served to keep basic telephone rates low. Thus, the more GTE and other ILECs lose the opportunity for contribution, the more compelling is the case that MCI's proposal would effect a taking. By contrast, the market-determined efficient component pricing rule, as explained in detail in Dr. Sibley's Report, derives a mechanism that prices GTE components at their economic costs. This price rule,

supplemented with a competitively neutral surcharge, is the proper -- and constitutional -- method for compensating GTE.

It is no answer to a taking that there may be alternate funding available at some later point through a universal service fund ("USF"). 47 U.S.C. § 254. Indeed, the very fact that Congress has recognized that there is a need for the USF only underscores why there would be an unconstitutional taking if MCI's proposal were adopted. The whole point of the USF is that Congress recognized that local telephone service has been subsidized by allowing higher-priced services -- like toll calling, business service, vertical services (voice mail, caller identification, call forwarding etc.) -- to keep rates low for preferred classes of customers. Yet that is precisely what is at issue here. Moreover even if this were somehow an answer (and it is not), it would only be a partial answer because the USF is designed to recover only a limited portion of historical and forward-looking costs. And, in addition, the USF will not go into effect for quite some time -- which would leave GTE uncompensated until that time and wrongfully leave the burden on GTE to bring a separate action to recover those lost funds.

4. GTE's Costs Of Unbundling And Resale.

As described in more detail elsewhere in GTE's submission (Testimony of GTE witnesses Wood, Wellemeyer, and Sibley, respectively), unbundling and resale entail economic costs -- both direct production costs and transaction costs. There is no justification for compelling GTE to bear these costs. To be sure, MCI would no doubt prefer GTE to bear these costs, but the Constitution requires that GTE be compensated

for these additional costs. These are real costs that will be no less if GTE bears them, as opposed to MCI.

5. Prohibition Against Overstated Avoided Costs.

With respect to resale, the Takings Clause prohibits the use of overstated avoided costs to drive down the wholesale price, as MCI would like to do. Under the Act, the Commission must establish a rate for the resale of telecommunications services pursuant to 47 U.S.C. § 251(c)(4). The Act provides for a pricing methodology based on the ILEC's wholesale rates, which are established by taking the retail rate less the avoided costs. 47 U.S.C. § 252(d)(3) (1996). The FCC has issued regulations in which it identifies a number of "avoided costs," but leaves to the States the application of this definition. First Report and Order ¶¶ 907-10.

As explained above (Part I), the FCC has also provided a default range of discount rates (17-25%) from the retail price. Id. And the FCC's proposed range would require GTE to sell its services below cost. As such, these proposed discount rates are insufficient to allow GTE to recover its costs associated with providing its various services subject to resale pursuant to the Act. Instead, the Commission should opt to implement a wholesale rate formula consistent with M-ECPR. (Sibley Report.) Anything less would be an unconstitutional, confiscatory taking.

If the Commission were to adopt the even more excessive, overstated "avoided costs" proposed by MCI, then that too would amount to a taking. MCI's overstated "avoided cost" assumes (incorrectly) that GTE would leave the retailing business entirely and that any lost sale has a corresponding, equal per-unit reduction in avoided costs of retailing (marketing, advertising, and billing). Thus, under MCI's

overreaching method, for example, if GTE produced 100 units and its cost of retailing, marketing, and billing were $20, then MCI would propose that the avoided costs on each unit would be $0.20 (i.e., $20 ÷ 100 units = $0.20). Under MCI's theory, if GTE sold 50 units at resale, its cost savings would be exactly ½ of $20 (or $10), and if it sold 100 units at resale, its avoided costs would be the full $20. That is to say, every unit of service has a corresponding, equal unit of retailing costs.

This does not, however, properly represent GTE's actual avoided costs. Consider, for example, one element of retailing costs -- advertising. MCI's improper avoided-cost proposal would reduce GTE's advertising expenditures in direct proportion to the units of resale service provided. In reality, though, GTE's advertising dollars would probably be unaffected by the provision of resale services, unless of course GTE were to exit the retail business entirely -- which, of course, is the logic behind MCI's incorrect analysis.

MCI's entire position on resale appears to be motivated by its desire to take advantage of GTE's position as the incumbent and engage in "cream skimming" tactics -- choosing no doubt to build facilities in high-margin areas. MCI will most likely leave the job of serving high-cost areas to GTE. That is to say, it will rely on resale to build out its system, while avoiding all of the costs associated with a facilities-based network in the low-margin areas while GTE will retain universal service and carrier-of-last-resort obligations. Congress no doubt did not intend for competitors like MCI to be able to engage in such strategic behavior.

B. GTE Must Be Allowed A Reasonable Return on Its Historic Costs.

MCI's proposal forbids the recovery by GTE of **any** return on its historic, or embedded costs in building the very network with which it now seeks interconnection. Yet, it has long been settled that the Takings Clause requires a fair rate of return for regulated utilities on their investments. See, e.g., Duquesne, 488 U.S. 299. The question for regulators has traditionally been "On which investments is the utility entitled to a fair rate of return?" In his concurrence in Duquesne, Justice Scalia correctly concluded that for purposes of determining whether a taking has occurred, all "prudently inccurred investment[s] may well have to be counted." Id. at 317. That is to say, at a minimum, the Commission must include **all** prudently incurred investments by GTE in constructing the very network that the government would now take from the Company for the use of third parties. Thus, GTE is entitled to recover that portion of its historic costs not yet recovered and to earn a fair rate of return on those investments.

MCI has presented no evidence demonstrating that GTE's investments in constructing the local exchange network were not prudently incurred or should be excluded. Nor could it, for those very investments were the subject of close regulatory scrutiny by this very Commission. Thus, to the extent that MCI now seeks access to GTE's network, it should have to either pay for an appropriate share of (and return on) those historic costs or GTE should otherwise be made whole through a rate rebalancing, end user charge, or one-time payment that would account for the monies prudently spent by GTE but now stranded by the transition from regulation to competition.

If the Commission were to afford GTE anything less than a fair rate of return on the very historic costs that the Commission induced GTE to spend to create the local exchange network, it would also run afoul of the principle that a regulator may not switch "back and forth between methodologies in a way which required investors to bear the risk of bad investments at some times while denying them the benefit of good investments at others". Duquesne, 488 U.S. at 315. Indeed, given that the "end result" test in Duquesne has no application where there has been a transition, as here, from regulation to competition, then the Commission's close scrutiny of each element of GTE's expenditures -- including historic, sunk costs -- is compelled by longstanding case law requiring a fair rate of return for a regulated utility.

Thus, the Commission needs to adjust its calculations to either the rate base or to future rate of return to reconcile its obligations to GTE. Alternatively, it may prefer to address this issue in a franchise-impact proceeding. The central issue though remains the same -- GTE must receive fair compensation; the method by which that happens is secondary.

Conclusion

For all of the reasons described above and elsewhere in our response, the Commission must avoid an unconstitutional taking of GTE's property without just compensation by ensuring that GTE will recover its forward-looking costs and any portion of its historic costs not yet recovered and earn a fair rate of return on that investment.

PART VI

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF CHARLES F. BAILEY

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Charles F. Bailey. My business address is 600 Hidden Ridge, Irving, TX, 75038.

Q. ARE YOU THE SAME CHARLES F. BAILEY WHO FILED DIRECT TESTIMONY IN RESPONSE TO AT&T'S ARBITRATION PETITION IN DOCKET 960847-TP?

A. Yes. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony set forth GTE's position with regard to other carriers' access to GTE's poles, conduits, and rights-of-way. The discussion was in the context of AT&T's arbitration request.

Q. HAVE AT&T AND MCI RAISED ESSENTIALLY THE SAME ISSUES WITH REGARD TO ACCESS TO GTE'S POLES, CONDUITS, AND RIGHTS-OF-WAY?

A. Yes, I believe AT&T and MCI present fundamentally the same issues. GTE's position in response to their respective requests for access to poles, conduits, and rights-of-way will thus be the same. Because it

would be unduly repetitive to submit wholly new testimony in response to MCI, I am therefore adopting my Direct Testimony in the AT&T arbitration as my Direct Testimony in this MCI arbitration. This approach is consistent with the Commission's consolidation of these two proceedings. If there are any outstanding MCI-related matters, I will address them in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART VII

GTE FLORIDA INCORPORATED

TESTIMONY OF DOUGLAS E. WELLEMEYER

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Douglas E. Wellemeyer. My business address is 4100 North Roxboro Road, Durham, North Carolina.

Q. ARE YOU THE SAME DOUGLAS E. WELLEMEYER WHO FILED DIRECT TESTIMONY IN DOCKET 960847-TP, THE ARBITRATION BETWEEN AT&T AND GTE?

A. Yes. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony addresses the development of GTE's proposed wholesale prices for all services offered for resale. I offer and explain two avoided cost studies prepared by GTE in support of its proposed prices.

Q. DO THE CONCEPTS YOU ADVOCATED IN YOUR TESTIMONY IN THE AT&T CASE APPLY EQUALLY TO MCI?

A. Yes. The proper determination of wholesale prices under the methodologies I present will not change regardless of the identity of the entity to which GTE sells its wholesale services. As such, it would

be unduly repetitive to offer wholly new testimony with regard to MCI, particularly because the AT&T and MCI arbitrations have now been consolidated. For this reason, I am adopting my Direct Testimony in the AT&T arbitration as my Direct Testimony in the MCI arbitration. I will address any MCI-specific issues and positions in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART VIII

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY DAVID S. SIBLEY

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is David S. Sibley, University of Texas at Austin, 22nd and Speedway, Austin, TX, 78712.

Q. ARE YOU THE SAME DAVID S. SIBLEY WHO FILED DIRECT TESTIMONY IN DOCKET 960847-TP, THE ARBITRATION BETWEEN GTE FLORIDA INCORPORATED (GTE) AND AT&T OF THE SOUTHERN STATES (AT&T)?

A. Yes, I am. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED DIRECT TESTIMONY?

A. That Testimony provided an economic analysis of the issues to be arbitrated between AT&T and GTE.

Q. ARE THOSE ISSUES SIMILAR TO THOSE TO BE ARBITRATED BETWEEN MCI AND AT&T IN THIS PROCEEDING?

A. Yes, it is my understanding that most of the issues involved in the arbitration are the same. For this reason, the Commission has consolidated the MCI and AT&T arbitrations.

Q. DO THE PRINCIPLES SET FORTH IN YOUR DIRECT TESTIMONY IN GTE'S RESPONSE TO AT&T'S PETITION APPLY WITH EQUAL FORCE TO THIS ARBITRATION WITH MCI?

A. Yes. My conclusions there regarding the proper way to set prices for wholesale services and unbundled network elements under the Telecommunications Act of 1996 do not change with the identity of the company requesting resale or unbundling. As such, to avoid undue repetition--particularly in view of the consolidation of the MCI and AT&T cases--I am adopting my Direct Testimony in the AT&T case as my Direct Testimony in this proceeding with MCI. Any MCI-specific issues and positions will be addressed in my Rebuttal Testimony.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART IX

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF DENNIS B. TRIMBLE

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND TITLE.

A. My name is Dennis B. Trimble. My business address is 600 Hidden Ridge Drive, Irving, Texas, 75015.

Q. ARE YOU THE SAME DENNIS B. TRIMBLE WHO FILED DIRECT TESTIMONY IN DOCKET 960847-TP, THE ARBITRATION BETWEEN GTE AND AT&T?

A. Yes. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. Through that Testimony, I sponsored GTE's cost studies for (1) unbundled network elements and associated ordering/provisioning non-recurring charges; (2) interconnection elements; (3) collocation elements; and (4) service provider number portability. I also presented GTE' s proposed pricing for each of these categories of elements.

Q. DO THE COST STUDIES AND PRICING PROPOSALS YOU PRESENTED IN RESPONSE TO AT&T'S PETITION HOLD TRUE WITH REGARD TO MCI AS WELL?

A. Yes. These same costing and pricing principles apply to both AT&T's and MCI's requests for interconnection and unbundling. As such, it would be unduly repetitive to submit wholly new testimony with regard to MCI. I am therefore adopting my Direct Testimony filed in the AT&T arbitration as my Direct Testimony in this MCI arbitration. This approach is consistent with my understanding that the AT&T and MCI arbitrations have been consolidated for resolution in a single docket. To the extent GTE needs to address MCI-specific issues and positions, I will do that in my Rebuttal Testimony to be filed later.

Q. IN ADDITION TO YOUR TESTIMONY ON THE PRINCIPLES UNDERLYING GTE'S COST STUDIES, ARE YOU GTE'S EXPERT ON THE PARTICULARS OF THE COST STUDIES THEMSELVES?

A. No. GTE will sponsor another witness, Bert Steele, to answer specific questions on the details of the cost studies themselves.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF BERT I. STEELE

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR FULL NAME AND BUSINESS ADDRESS.

A. My name is Bert I. Steele. My business address is 600 Hidden Ridge Drive, Irving, Texas 75038.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by GTE Telephone Operations as Manager - Pricing and Tariff Support. In this capacity I have responsibility for supporting incremental cost models and their application to support the pricing of network services for all of the GTE Telephone Operations including GTE Florida Incorporated ("GTEFL" or "Company").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE.

A. I have a Bachelor of Science Degree in Mathematics from Gannon University and a Master of Engineering Degree in Engineering Science from Pennsylvania State University. I joined GTE in 1972 with General Telephone Company of Pennsylvania. During the course of my career with GTE, I have held various valuation engineering, marketing, product management, and regulatory positions throughout GTE Telephone Operations including

GTE Hawaiian Tel. I assumed my present position in January of 1994.

Approximately fourteen of my twenty-four years with GTE have been in the area of developing incremental costs for pricing decisions. I have taken a number of incremental cost and pricing courses from AT&T, Bellcore, United States Telephone Association ("USTA"), GTE and the University of Chicago. For seven years I have been an active participant of the USTA Economic Cost Analysis Subcommittee and the USTA Training/Education Work Group responsible for promoting awareness, understanding and proper application of economic principles. At present, I am the chairman of the USTA Economic Analysis Training/Education Work Group.

Q. HAVE YOU TESTIFIED BEFORE THIS OR ANY OTHER STATE REGULATORY COMMISSION?

A. I have testified on behalf of GTE's telephone operating companies as an expert witness in the area of incremental costing before five state public utility commissions: California, Pennsylvania, Oklahoma, Wisconsin and Illinois.

Q. WHAT IS THE PURPOSE OF YOUR PARTICIPATION IN THIS PROCEEDING?

A. I am not introducing any substantive prefiled testimony at this time. My reason for participating in these consolidated dockets is to answer

specific questions about the cost studies sponsored by GTE witness Trimble. Because of the volume of the cost studies, it is more efficient to make available a separate witness with detailed knowledge of the studies, in the event the Commission, MCI or AT&T have questions that would reach beyond the costing principles and methodologies.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. It does.

PART X

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF RODNEY LANGLEY

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Rodney Langley. My business address is 600 Hidden Ridge, Irving, TX, 75038.

Q. ARE YOU THE SAME RODNEY LANGLEY WHO FILED DIRECT TESTIMONY IN DOCKET 960847-TP, THE ARBITRATION BETWEEN GTE AND AT&T?

A. Yes. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony discussed the open issues between GTE and AT&T with respect to AT&T's requests for access to GTE's operations support systems (OSS), and presented GTE's position on such access.

Q. DOES MCI'S PETITION FOR ARBITRATION RAISE ESSENTIALLY THE SAME ISSUES AS AT&T'S PETITION?

A. Yes, I believe MCI's proposals regarding the nature and terms of access to GTE's OSS are very similar to those advanced by AT&T. GTE's response to MCI's requests will thus be fundamentally the

same. For this reason, I am adopting my Direct Testimony in the AT&T arbitration as my Direct Testimony in the MCI arbitration. This approach will avoid undue repetition, particularly since the AT&T and MCI dockets have been consolidated into a single proceeding. If there are any issues or positions that are MCI-specific, I will address them in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART XI

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF BEVERLY Y. MENARD

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Beverly Y. Menard. My business address is One Tampa City Center, Tampa, Florida 33601-0110.

Q. ARE YOU THE SAME BEVERLY Y. MENARD WHO FILED DIRECT TESTIMONY IN DOCKET 960847-TP, THE ARBITRATION BETWEEN AT&T AND GTE?

A. Yes. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. I presented GTE's position on number portability in the context of AT&T's Petition for Arbitration.

Q. DO THE GENERAL PRINCIPLES ADVANCED IN THAT DIRECT TESTIMONY APPLY TO MCI AS WELL?

A. Yes, they do. My Testimony explained the number portability requirements under the Telecommunications Act of 1996, described the relative merits of various types of number portability, and set forth GTE's position on the most appropriate method of interim portability. These same general matters apply equally to the MCI and AT&T

proceedings. Thus, to avoid undue repetition, particularly now that the MCI and AT&T arbitrations have been consolidated, I am adopting my Direct Testimony in the AT&T arbitration as my Direct Testimony in the MCI arbitration. To the extent that MCI's specific number portability proposals are different from AT&T's, I will address those differences in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART XII

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF GREGORY M. DUNCAN

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Gregory Michael Duncan. My business address is 555 South Flower St., Suite 4100, Los Angeles, CA 90071.

Q. ARE YOU THE SAME GREGORY M. DUNCAN WHO FILED DIRECT TESTIMONY IN DOCKET 960847-TP, THE ARBITRATION BETWEEN GTE AND AT&T?

A. Yes. I submitted that Testimony on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony provided an economic evaluation of Version 2.2 of the Hatfield Model, which AT&T relies upon to estimate the costs of incumbent local exchange carrier network elements.

Q. DOES MCI ALSO USE THE HATFIELD MODEL TO DERIVE PRICES FOR UNBUNDLED ELEMENTS?

A. Yes, it does. My evaluation of the Model and conclusions about its shortcomings will, of course, remain constant, regardless of the identity of the party supporting the Model. For this reason, it would be unduly repetitive to submit wholly new testimony in response to

this aspect of MCI's arbitration filing. I am therefore adopting my Direct Testimony in the AT&T arbitration as my Direct Testimony in this proceeding with MCI. This approach is consistent with the Commission's consolidation of the AT&T and MCI arbitrations. Any MCI-specific modifications of the Hatfield Model will be addressed in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

PART XIII

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF MEADE C. SEAMAN

DOCKET NO. 960980-TP

Background

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Meade C. Seaman. My business address is 600 Hidden Ridge, Irving, Texas.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR POSITION?

A. I am employed as Director -- Local Competition/Interconnection Program Office for GTE Telephone Operations, which has telephone operations in 28 states.

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL AND WORK EXPERIENCE.

A. I graduated from the University of South Florida in 1976 with a Bachelor's degree in Accounting. In 1988, I graduated from Indiana Wesleyan University with an M.B.A.

I began my career in the telecommunications industry in 1976 with General Telephone Company of Florida as a Business Relations Assistant. In 1983, I joined GTE Service Corporation in Irving, Texas, as Staff Manager--Interchanged Service

Compensation. In 1985, I was named Director--Regulatory and Industry Affairs, where I was responsible for the development and coordination of all non-rate case related proceedings. In October 1994 I became Director-Demand Analysis and Forecasting, where my responsibilities included forecasting of all line-related and usage-related services. I was recently appointed to my current position as Director--Local Competition/Interconnection Program Management Office.

Q. WHAT ARE YOUR PRINCIPAL RESPONSIBILITIES IN YOUR CURRENT POSITION?

A. My principal responsibilities include negotiating interconnection, unbundling, and resale agreements with requesting carriers and developing policies relating to local competition. I also am responsible for leading GTE's arbitration efforts.

Q. HAVE YOU TESTIFIED IN OTHER PROCEEDINGS?

A. Yes. I have testified before the commissions in Ohio, Indiana, Missouri, Pennsylvania, Wisconsin, Iowa and Illinois.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. The purpose of my testimony is to (1) describe GTE's negotiations with MCI, and (2) summarize GTE's Response to the fundamental issues raised in MCI's Petition. But first, I will briefly discuss the

Telecommunications Act of 1996 and the FCC's implementing rules as they relate to GTE's pricing proposal.

The Telecommunications Act and the FCC's Rules

Q. PLEASE COMMENT ON THE TELECOMMUNICATIONS ACT OF 1996 (THE ACT) AND THE IMPLEMENTING RULES ADOPTED BY THE FEDERAL COMMUNICATIONS COMMISSION IN ITS FIRST REPORT AND ORDER.

A. The Act itself is unprecedented, and makes fundamental changes to the local telecommunications industry. Specifically, the Act is intended to encourage competition by requiring incumbent local exchange carriers (ILECs) such as GTE to provide interconnection and access to unbundled network elements at cost-based rates, and to offer services for resale at wholesale rates based on an ILEC's avoided costs.

The FCC's rules, however, contradict the Act on several significant points. For example, MCI requests interconnection, services, and unbundled elements under § 251(c) of the Act. The prices for these facilities and services are subject to the pricing standards set forth in § 252(d)(1)-(3). The Act expressly provides that the ***State commissions*** have exclusive authority to establish and apply these standards. The FCC, however, has set out detailed rules and methodologies of its own for these pricing

standards, precluding States from considering other methodologies.

What is most troubling about the FCC's Order is that it establishes "default proxy rates" for wholesale services and unbundled elements that States may adopt as interim rates pending a hearing on the merits. GTE is very concerned with this proposal. First, as discussed in our prehearing brief, we believe the FCC improperly assumed the State's rate-setting function and exceeded its statutory authority. Second, we believe the FCC's default rates are erroneous, and while MCI may disagree with us, we believe we are entitled to a hearing on the merits as well as an opportunity to present our case ***before*** rates can be imposed upon GTE.

A related concern is that the recombining of unbundled elements contemplated by the FCC Order would allow bypass of access charges and also allow avoidance of the appropriate resale pricing standards. The FCC's Order violates the intent of the Act not to change the level and application of carrier access charges. For example, the Order arbitrarily sets end office switching prices at the proxy range of 2 to 4 mils, and it arbitrarily reduces the residual interconnection charge (RIC) to three-quarters of its former level. As a further example, it established without hearing

or cause a sunset period for application of carrier common line charges and the three-quarters of the RIC.

Along these same lines, I would like to note that in my experience, regulatory bodies have devoted more time to general rate proceedings and other, more "common" regulatory matters than to this proceeding, where the Commission must resolve fundamental issues resulting from the reorganization of an entire industry. We recognize that the time lines are imposed by federal law, not State commissions, but we need to ensure that the fundamental issues -- such as those relating to pricing and costing -- receive the attention they deserve.

Q. TO THE EXTENT THAT MCI WOULD SUPPORT IMPOSITION OF THE FCC'S PROXY RATES, EVEN ON AN INTERIM BASIS, WOULD GTE BE HARMED BY THESE RATES?

A. Yes, GTE would be irreversibly harmed in ways that no retroactive "true-up" mechanism could correct. While it is conceivable that the State could order such retroactive treatment from a revenue perspective, the market cannot be retroactively corrected. If unbundled rates are set at levels below cost, new entrants will have the ability to attract more customers than they otherwise would be capable of attracting away from GTE. Once this excessive share loss occurs, it would be impossible for the State to correct for the problem from a customer perspective. It is very

costly for all firms to win back a customer once lost to another competitor. For all these reasons, and for the reasons set forth in our Arbitration Brief and Response, GTE believes that the FCC's proxy rates should not be applied.

Q. IS GTE PREPARED TO PROPOSE ITS OWN PRICES FOR WHOLESALE SERVICES, UNBUNDLED ELEMENTS, AND INTERCONNECTION?

A. Yes, it is. However, the prices for network elements are not compensatory due to GTE's distorted rates. Wholesale rates and retail rates must be consistent and rational for all the rates set. GTE's wholesale rates for unbundled elements reflect market considerations, but GTE's retail rates were set with certain public policy goals in mind, most notably the goal of universal service. These goals allowed prices for some services to be set below their economic costs, while other services were priced far above costs as a source of contribution for the below-cost services. Other examples of historical ratemaking policy include statewide rate averaging and class of service pricing. As long as GTE was the single provider, the public policy goals could be achieved.

Now, however, competition has been introduced in the local exchange market. In that event, there arises a mismatch between, on the one hand, the pricing methodology historically used for determining retail and wholesale rates (where rates will

not uniformly reflect costs) and, on the other hand, the cost-based pricing required by the Act for unbundled elements and interconnection.

For this reason, GTE respectfully requests that the Commission move expeditiously to establish a uniform and consistent set of pricing policies that can be applied to the pricing of all of GTE's services -- retail, wholesale, and unbundling.

Background on MCI Negotiations

Q. WOULD YOU BRIEFLY DESCRIBE THE HISTORY OF GTE'S NEGOTIATIONS WITH MCI?

A. Yes. The parties have held numerous meetings to identify MCI's requirements as detailed in MCI's Exhibit 2. The parties' efforts were reflected in this comprehensive document, which the parties used to outline their position on each issue. The status of each item was shown as disagree, agree, or conditional on a matrix (Executive Meeting, August 2). Not surprisingly, the parties disagree on the fundamental issue of pricing methodology, and this core issue must be resolved here.

Q PLEASE ELABORATE ON HOW THIS MATRIX WAS DEVELOPED.

A. The matrices are divided into eight areas: (1) Collocation, (2) Ancillary Services, (3) Business Processes, (4) Rights of Way, (5) Resale, (6) Interconnection and Reciprocal Compensation, (7)

Unbundling, and (8) Numbering. For example, two of the resale issues we discussed were GTE's provisioning of voice messaging and inside wire maintenance to MCI's customers. Both of these services are non-telecommunications services as defined by the FCC. Now, however, it appears that MCI wants GTE to resell these services under the avoided cost rate referenced in the Act. We believe these issues, and all other issues of this nature, should not be addressed in this arbitration because, as the parties agreed earlier, they are business-related issues unrelated to the Act's requirements. Of course, if we have misread MCI's Petition and supporting documentation and MCI is not raising these issues in this arbitration, then GTE will discuss these business issues outside of arbitration.

Q. HOW DID THE PARTIES KEEP TRACK OF THE MANY ISSUES INVOLVED IN THEIR NEGOTIATIONS?

A. The parties cooperated in developing the matrix I already described above to keep track of all the issues. Many of the items on which the parties had agreed were subject to only two qualifications: (1) that GTE must receive a fair price for its services and property, and (2) that GTE must recover the costs it incurs in accommodating MCI's requests. Issues that could not be resolved at the SME level were put into a matrix and written up. This matrix is referred to as the "Core Team Matrix" and has

been included in GTE's filing as Exhibit No. MSC-1..

Q. DID THE PARTIES NEGOTIATE A DRAFT CONTRACT?

A. No. However, draft contracts have been exchanged. Detailed negotiations are ongoing.

Summary of GTE's Response

Q. PLEASE SUMMARIZE GTE'S RESPONSE TO MCI'S PETITION.

A. In this summary, I have divided the issues into four major categories: (1) wholesale services; (2) unbundled elements; (3) interconnection; and (4) "back office" issues such as ordering, provisioning, and systems implementation, functions that take place in the "back office" and that customers are usually not aware of.

Wholesale Services

Q. WHAT SERVICES WILL GTE OFFER ON A WHOLESALE BASIS TO MCI?

A. GTE will offer all the services it currently offers on a retail basis except for those set forth in the testimony of GTE's wholesale services/avoided cost witness. The services GTE will not offer on a wholesale basis include, for example, below-cost services, promotional services, and services that are already provided on a wholesale basis (e.g., special access sold to carriers and private line services offered predominately to carriers).

Q. **WHY DOES GTE EXCLUDE THESE SERVICES?**

A. Let me first address GTE's position with respect to below-cost services. Under GTE's current rates, certain services are priced below cost. These services receive contributions from other services, such as intraLATA toll, access, and vertical and discretionary services, all of which are priced above incremental cost. If GTE were required to offer its below-cost services on a wholesale basis, then other carriers would (1) obtain avoided-cost discounts for both below-cost and above-cost services, and (2) be able to pocket the contributions from the above-cost services that had been used to price the other services below-cost. Accordingly, GTE could not cover its total costs unless these services are excluded from GTE's wholesale offerings or are repriced to cover their costs.

Second, GTE should not be required to offer services such as promotions on a wholesale basis; otherwise GTE would not be able to differentiate its retail services from those of competing carriers. Put another way, a competitor will be able to offer any service it wants on any terms and conditions it desires to attract new customers, and GTE needs this same flexibility to respond to competition on a retail basis and give its customers more choices.

For example, if GTE offers a special promotion to its customers but is required to provide that same promotion to MCI on an

avoided cost basis, then GTE could never differentiate its offerings from those of MCI. Importantly, GTE would have absolutely no incentive to develop additional promotions and other new services that would benefit customers because MCI could take and use them for its own marketing and economic advantage. In fact, GTE could never differentiate its offerings from MCI's. This result is contrary to the purpose of the Act by limiting choices to customers. The Act should be implemented in a manner that allows all carriers to respond to competition, including GTE.

Q. HOW SHOULD THE SERVICES GTE OFFERS ON A WHOLESALE BASIS BE PRICED?

A. These services should be priced as follows: Retail price minus GTE's actual avoided cost, plus the wholesale costs GTE incurs, plus opportunity cost. GTE's resale/avoided cost witness describes GTE's avoided cost methodology whereby costs are excluded on a work-element basis as opposed to using broad account categories. In this way, GTE's methodology captures GTE's true avoided costs, in accordance with the Act's requirements.

Unbundled Elements

Q. PLEASE DESCRIBE THE UNBUNDLED ELEMENTS GTE WILL PROVIDE TO MCI.

A. GTE will offer on an unbundled basis the following:

(1) the loop, which is in general the transmission facility which extends from a main distribution frame to the customer premises; (2) the port, which in general is the line card and associated peripheral equipment on a GTE end office switch that serves as the hardware termination for the customer's exchange service on that switch, generates dial tone and provides the customer a pathway to the public switched telecommunications network; (3) transport, by which I mean the transmission facility which extends from a main distribution frame (MDF) to either another MDF or a meet point with transport facilities of MCI (unbundled transport is provided under rates, terms and condition of the applicable tariff); (4) signaling, which in general is SS7 signaling and transport service in support of MCI's local exchange service; and (5) certain databases in accordance with the rates, terms and conditions of applicable switched access tariff.

This description of unbundling means that MCI may lease and interconnect to whatever of these unbundled elements it chooses, and may combine these unbundled elements with any facilities or services that MCI may itself provide, pursuant to the following terms: first, the interconnection shall be achieved by expanded interconnection/collocation arrangements MCI shall maintain at the wire center at which the unbundled services are resident; and second, that each loop or port element shall be delivered to MCI's

collocation arrangement over a loop/port connector applicable to the unbundled services through other tariffed or contract options; and third, MCI can combine unbundled elements with its own facilities but should not be allowed to recombine GTE unbundled elements.

Q. GTE DOES NOT PROPOSE TO UNBUNDLE ITS SWITCH. PLEASE EXPLAIN.

A. GTE will provide the port, as I described above. Unbundling the switch, in other words, a-la-carte access to each switch function and feature, presents substantial problems. First, such unbundling is not technically feasible at this time, and it ignores the limitations on switch capacity. Second, it ignores the tremendous cost that would be associated with trying to develop these features into a-la-carte menu selections; they currently are not configured in that manner. Third, MCI would be able to avoid paying access charges.

Q. MCI WANTS TO BE ABLE TO OBTAIN UNBUNDLED ELEMENTS FROM GTE AND THEN REASSEMBLE THEM TO OFFER END-TO-END SERVICE. WHAT IS GTE'S POSITION ON THIS ISSUE?

A. As I alluded to earlier when describing the nature of MCI's access to the GTE unbundled elements, GTE strongly believes that MCI should not be permitted to unbundle and then reassemble GTE's network. Such a proposal by MCI would render meaningless the

Act's required distinction between unbundled elements and wholesale services -- that they be priced under different cost methodologies.

Q. HOW SHOULD THE PRICES FOR UNBUNDLED ELEMENTS BE SET?

A. The prices should be cost-based, as required by the Act. They should be set in a manner to allow recovery of GTE's actual costs of its actual network and should not be based on the theoretical costs of a network that has never been built, as MCI proposes. GTE has proposed a pricing methodology that meets the Act's requirements and that allows prices to be set by the market as competition develops. This methodology is discussed in detail in the Economic Report included in our Response.

Interconnection

Q. PLEASE DESCRIBE GTE'S POSITION ON THE APPROPRIATE PRICING OF INTERCONNECTION.

A. GTE's position on all pricing matters is that the Company should be given the opportunity to recover costs incurred in the operations of the Company from the "cost-causers." Sections 251(b)(5) and 252(d)(2) of the Act, as well as the FCC's order released August 8, 1996, set forth the standard for establishing reciprocal compensation arrangements. These standards provide for the mutual and reciprocal recovery of each carrier's costs,

calculating such amounts on the basis of the additional costs of terminating calls originated by the other carrier. A bill-and-keep arrangement is inconsistent with these standards unless costs of the two carriers are symmetrical and the volume of traffic terminated on each other's network is approximately equal.

"Back Office" Issues

Q. PLEASE DISCUSS GTE'S POSITION ON ISSUES SUCH AS OPERATOR SUPPORT SYSTEMS, BILLING, PROVISIONING, MAINTENANCE, SYSTEMS INTERFACES, AND OTHER "BACK OFFICE" ISSUES.

A. GTE believes that many of these issues need to be approached on an industry-wide basis, especially as they relate to GTE, which operates in 28 states. System interfaces are an important issue not just for MCI but for all competitive carriers that want to interconnect with GTE. For example, GTE uses a standard, nationwide billing system, and it would not be appropriate for each state to establish unique interface standards that simply will not work in a single system that serves many states and many competitive carriers. For this reason, GTE believes these back office issues are best resolved in an industry-wide setting or workshops after the fundamental issues of pricing and costing are resolved on a state-specific basis. A key issue that unites all of these issues is the very important element of cost. As and when changes are to be made to satisfy MCI's particular desires, the

carrier causing the change -- in this case MCI -- must pay for the cost of making the change.

The issues relating to specific back office functions and systems are discussed in the testimony of various GTE witnesses in this arbitration.

Term of Agreement; Indemnification

Q: DOES GTE HAVE A POSITION ON THE TERM OF ANY AGREEMENT WITH GTE AND MCI?

A. Yes. GTE believes the term of the agreement should be limited to no more than two years. Given the unprecedented scope of the Act and all the issues raised, it would not be prudent to enter into a long-term contract.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Interconnection and Reciprocal Compensation

Term	MCI Position	GTE Position
Number of POIs	Single POI per local calling area.	Agree. GTE agrees to interconnect at each tandem; end office level as MCI chooses.
Traffic Type	No restrictions on traffic types.	Conditional. Separate trunk groups may be required.
Location of Interconnection	Interconnection at any feasible point.	Conditional. Mutually agreed points.
Reciprocal Compensation	Mutual Traffic Exchange for local traffic. At TSLRIC if persistently out of balance.	Conditional. Negotiated rate rather than TSLRIC.
Other Compensation	All other interconnect services priced at TSLRIC.	Conditional. Negotiated rate rather than TSLRIC.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

Interconnection and Reciprocal Compensation (cont.):

Intelligent Network and Advanced Intelligent Network

Term	MCI Position	GTE Position
Full Implementation	Implement AIN/IN interconnection points to fully unbundle the ILEC AIN/IN network.	Disagree. AIN services will be available for resale, provided the appropriate signalling protocols are used. Access to the STP will allow MCI immediate **provision of AIN service. Basic and enhanced platform available.**
Non-mediated Access	Without mediation, provide access to ILEC AIN switch triggers, service creation and management platforms, and exchanges of messages between ILEC SSP and MCI's SCP.	Disagree. Other than access to the SMS, access to AIN network elements is neither technically or operationally feasable at this time.
Implementation of IILC Issue #026	Ensure agreement and implementation of IILC Issue #026 defined interconnection points by May 1998.	Conditional. GTE is a participant in the Industry IN Project, which seeks to identify and resolve the issues associated with unbundling the AIN. It is premature to anticipate that the interconnection points will be defined by May 1998.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

Unbundling

All elements and sub-elements to be unbundled and available for discrete purchase.

Term	MCI Position	GTE Position
Loops	Local Loop Sub Loops	Agree. Conditional. Will not be tariffed; available on ICB basis.
Switching	Local and Tandem Switching Switching Sub-elements	Conditional. Yes for signalling, no for databases.
Transport	Dedicated Transport Common Transport Multiplexing Dark Fiber	Agree. Transport is tariffed as access. Agree. Common transport is tariffed as access. Agree. Tariffed in access tariff. Disagree.
Databases	Databases for call and non-call processing.	Disagree. Yes if needed for signalling, no for databases.
Data	Access to Data Networks (ATM, FR)	Agree. Available via general exchange tariff.
Compensation	All elements and sub elements to be priced at TSLRIC.	Disagree. TSLRIC is intended to be a price floor. Pricing should include contribution to joint and common costs.
Combinations of Elements	No restrictions on how elements can can be combined.	Agree. As long as technically possible.

Refer to MCI Requirements for Intercarrier Agreements for full details

Resale

Term	MCI Position	GTE Position
Service Available	All services offered to end users of the ILEC available for resale.	Conditional. No card, voice mail or inside wire is planned for resale.
Price Differential	A single avoided cost differential of 29%.	Conditional. GTE will request pricing based on avoided cost by service category.
Offers Available	Calling plans, promotional offerings, grandfathered and new services available for resale.	Conditional. All agreed except promotions. Promotional offerings are a primary form of competition, often involving intro rates below standard retail, to generate new demand.
Branding	Carrier Specific Branding	Disagree. Unbranded except for techs, DA, OS.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

Numbering Issues

Term	MCI Position	GTE Position
Interim Implementation	Immediate interim solution; RCF and Flex DID.	Conditional. RCF tariffed; Flex DID not planned.
Long Term Solution	Implement long term solution per FCC order.	Disagree. GTE plans to file petition for Recon on FCC order.
Cost Recovery	Competitively neutral cost recovery for ILNP and LNP.	Agree.
Access Charges	Access charges on ILNP should be meetpoint billed per FCC order.	Conditional. GTE agrees that a portion of the access belongs to MCI. Meet point to be negotiated.
NXX Allocation	Non-discriminatory allocation of NXXs to CLECs while ILEC administrating numbering.	Agree.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

Collocation

Term	MCI Position	GTE Position
Availability	Physical collocation available at any ILEC operating facility.	Conditional. Will offer physical on a space available basis. Prefers virtual.
Equipment Restrictions	No restrictions on collocation equipment.	Disagree. No equipment that can perform switching functions.
CLEC Interconnect	CLECs able interconnect with each other at collocation, bypassing ILEC switch.	Disagree. Collocation space should be used for interconnection to ILEC only.
Build Out Facilities	Ability to lease facilities from the collo via ILEC or CLEC.	Conditional. GTE to check. Agree with purchase out of access tariff. Disagree with CLEC to CLEC interconnect.
Compensation	Collocation and associated services priced at TSLRIC.	Disagree. TSLRIC plus overhead and contributions.
Lead Times to Establish New Collo	Maximum 90 days to establish a new collocation.	Conditional. 90 days is reasonable interval, with exceptions beyond control.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

Ancillary Services:
911

Term	MCI Position	GTE Position
Access to Elements	Non-discriminatory access to 911 switches, databases and other network elements.	Agree.
Compensation	All services and elements priced at TSLRIC.	Disagree.

Refer to MCI Requirements for Intercarrier Agreements for full details

Ancillary Services:
Directory Assistance

Term	MCI Position	GTE Position
Exchange and Storage of Data	Mutual exchange and storage of customer data at no charge.	Disagree. GTE will provide storage for MCI data. Does not agree with exchange at no charge.
Access to DA Databases	ILEC to provide unbundled access to its database for directory assistance Operators to look-up data.	Disagree.
Compensation	Provide access to unbundled elements of Directory Assistance service at TSLRIC.	Disagree.
Branding	Carrier Specific Branding.	Conditional. Will provide MCI branding for facilities based; GTE branding for resale.

Refer to MCI Requirements for Intercarrier Agreements for full details

Ancillary Services:
Directory Listings

Term	MCI Position	GTE Position
MCI Information	ILEC to include MCI specific information in information pages of their directories.	Agree.
MCI Subscriber Listings	Publication of MCI subscriber listings in ILEC directories at no charge.	Agree. Primary Business and Residential White and Yellow Page listing provided.
Distribution	Distribution of directories to MCI subscribers on a non-discriminatory basis at no charge.	Agree. Initial distribution at no charge. Subsequent distribution charges at parity with GTE.
Non-Discriminatory Charges	Any charges applied to subscribers (e.g.. advertising, bolding) will be non-discriminatory.	Agree.

Refer to MCI Requirements for Intercarrier Agreements for full details

Rights of Way

Term	MCI Position	GTE Position
Access	Access to all Right of Way space (including building entrance links) not currently being used by the ILEC with equal priority to ILECs own requirements.	Conditional. Will provide parity with other CLECs and GTE affiliates. GTE reserves ROW with a five-year planning horizon. GTE does not control BEL.
Information	Regular reports on the capacity status and planned increases in capacity of all Rights of Way.	Disagree. Capacity reports not available.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

Business Processes

Term	MCI Position	GTE Position
Dedicated Ordering Centers	Dedicated CLEC centers for ordering, maintenance and trouble resolution.	Agree.
Hours of Operation	7 by 24 required for ordering, maintenance, and trouble resolution.	Conditional. 7 by 24 for maintenance and trouble. 8 by 8 Monday through Friday for ordering.
Scaleable Processes	Automated interim systems that are not limited in any way in the volumes that they can handle.	Disagree. Fax or Email only availalble means for order submission in the interim.
Interfaces	Automated interfaces with read and write access.	Conditional. GTE generally agrees with the need for these interfaces; timing and cost under review.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

Access

Term	MCI Position	GTE Position
Delivery at POI	Interexchange access traffic can be delivered at any POI.	Conditional. Traffic must be in separate trunk group at the POI.
Compensation	Interexchange access must be priced at TSLRIC.	Disagree.

Refer to MCI Requirements for Intercarrier Agreements for full details

Information Provision

Term	MCI Position	GTE Position
NDA	Non-disclosure agreement not required except for cost studies.	Agree. GTE has signed MCI's NDA.
Cost Studies	ILEC will produce cost studies under a NDA.	Disagree. GTE does not believe that the Act requires cost studies as a prerequisite for negotiation.
Co-Carrier Agreements	ILEC will make available all co-carrier agreements.	Disagree. Agreements made prior to Act will not be made available.

MCI

Refer to MCI Requirements for Intercarrier Agreements for full details

SECTION III

GLOSSARY

The following definitions are taken from Section 153 of the Telecommunications Act of 1996 and the FCC's First Report and Order. Some of the definitions taken from the FCC's First Report and Order apply to only certain FCC rules, and these rules are referenced in the appropriate definitions. GTE does not agree with all of the FCC's definitions, such as the FCC's definition of 'technically feasible', but these definition are provided here for convenience. Moreover, some of the definitions listed here may be inconsistent with State law.

* * *

Act. The Communications Act of 1934, as amended.

Advanced intelligent network. "Advanced Intelligent Network" is a telecommunications network architecture in which call processing, call routing, and network management are provided by means of centralized databases located at points in an incumbent local exchange carrier's network.

Arbitration, final offer. "Final offer arbitration" is a procedure under which each party submits a final offer concerning the issues subject to arbitration, and the arbitrator selects, without modification, one of the final offers by the parties to the arbitration or portions of both such offers. "Entire package final offer arbitration," is a procedure under which the arbitrator must select, without modification, the entire proposal submitted by one of the parties to the arbitration. "Issue-by-issue final offer arbitration," is a procedure under which the arbitrator must select, without modification, on an issue-by-issue basis, one of the proposals submitted by the parties to the arbitration.

Billing. "Billing" involves the provision of appropriate usage data by one telecommunications carrier to another to facilitate customer billing with attendant acknowledgments and status reports. It also involves the exchange of information between telecommunications carriers to process claims and adjustments.

Commission. "Commission" refers to the Federal Communications Commission.

Common carrier. The term "common carrier" or "carrier" means any person engaged as a common carrier for hire, in interstate or foreign communication by wire or radio or in interstate or foreign radio transmission of energy, except where reference is made to common carriers not subject to the Act [47 USC §§ 151 et seq.]; but a person engaged in radio broadcasting shall not, insofar as such person is so engaged, be deemed a common carrier.

Customer premises equipment. The term "customer premises equipment" means equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications.

Dialing parity. The term "dialing parity" means that a person that is not an affiliate of a local exchange carrier is able to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to the telecommunications services provider of the customer's designation from among 2 or more telecommunications services providers (including such local exchange carrier).

Directory assistance service. "Directory assistance service" includes, but is not limited to, making available to customers, upon request, information contained in directory listings.

Directory listings. "Directory listings" are any information: (1) identifying the listed names of subscribers of a telecommunications carrier and such subscriber's telephone numbers, addresses, or primary advertising classifications (as such classifications are assigned at the time of the establishment of such service), or any combination of such listed names, numbers, addresses or classifications; and (2) that the telecommunications carrier or an affiliate has published, caused to be published, or accepted for publication in any directory format.

Downstream database. A "downstream database" is a database owned and operated by an individual carrier for the purpose of providing number portability in conjunction with other functions and services.

Equipment necessary for interconnection or access to unbundled network elements. For purposes of section 251(c)(2) of the Act, the equipment used to interconnect with an incumbent local exchange carrier's network for the transmission and routing of telephone exchange service, exchange access

service, or both. For the purposes of section 251(c)(3) of the Act, the equipment used to gain access to an incumbent local exchange carrier's unbundled network elements for the provision of a telecommunications service.

Exchange access. The term "exchange access" means the offering of access to telephone exchange services or facilities for the purpose of the origination or termination of telephone toll services.

Incumbent Local Exchange Carrier (Incumbent LEC). With respect to an area, the local exchange carrier that: (1) on February 8, 1996, provided telephone exchange service in such area; and (2) (i) on February 8, 1996, was deemed to be a member of the exchange carrier association pursuant to 47 C.F.R. § 69.601(b); or (ii) is a person or entity that, on or after February 8, 1996, became a successor or assign of a member described in clause (i) of this paragraph.

Interconnection. "Interconnection" is the linking of two networks for the mutual exchange of traffic. This term does not include the transport and termination of traffic.

Local access and transport area. The term "local access and transport area" or "LATA" means a contiguous geographic area--

(A) established before the date of enactment of the Telecommunications Act of 1996 [enacted Feb. 8, 1996] by a Bell operating company such that no exchange area includes points within more than 1 metropolitan statistical area, consolidated metropolitan statistical area, or State, except as expressly permitted under the AT&T Consent Decree; or

(B) established or modified by a Bell operating company after such date of enactment and approved by the Commission.

Local Exchange Carrier (LEC). A "LEC" is any person that is engaged in the provision of telephone exchange service or exchange access. Such term does not include a person insofar as such person is engaged in the provision of a commercial mobile service under section 332(c) of the Act, except to the extent that the Commission finds that such service should be included in the definition of the such term.

Maintenance and repair. "Maintenance and repair" involves the exchange of information between telecommunications carriers where one initiates a request for maintenance or repair of existing products and services or unbundled network elements or combination thereof from the other with attendant acknowledgments and status reports.

Meet point. A "meet point" is a point of interconnection between two networks, designated by two telecommunications carriers, at which one carrier's responsibility for service begins and the other carrier's responsibility ends.

Meet point interconnection arrangement. A "meet point interconnection arrangement" is an arrangement by which each telecommunications carrier builds and maintains its network to a meet point.

Network element. A "network element" is a facility or equipment used in the provision of a telecommunications service. Such term also includes, but is not limited to, features, functions, and capabilities that are provided by means of such facility or equipment, including but not limited to, subscriber numbers, databases, signaling systems, and information sufficient for billing and collection or used in the transmission, routing, or other provision of a telecommunications service.

Number portability. The term "number portability" means the ability of users of telecommunications services to retain, at the same location, existing telecommunications numbers without impairment of quality, reliability, or convenience when switching from one telecommunications carrier to another.

Operator services. "Operator services" are any automatic or live assistance to a consumer to arrange for billing or completion of a telephone call. Such services include, but are not limited to, busy line verification, emergency interrupt, and operator-assisted directory assistance services.

Physical collocation. "Physical collocation" is an offering by an incumbent LEC that enables a requesting telecommunications carrier to:

(1) place its own equipment to be used for interconnection or access to unbundled network elements within or upon an incumbent LEC's premises;

(2) use such equipment to interconnect with an incumbent LEC's network facilities for the transmission and routing of telephone exchange service, exchange access service, or both, or to gain access to an incumbent LEC's unbundled network elements for the provision of a telecommunications service;

(3) enter those premises, subject to reasonable terms and conditions, to install, maintain, and repair equipment necessary for interconnection or access to unbundled elements; and

(4) obtain reasonable amounts of space in an incumbent LEC's premises, as provided in this part, for the equipment necessary for interconnection or access to unbundled elements, allocated on a first-come, first-served basis.

Pre-ordering and ordering. "Pre-ordering and ordering" includes the exchange of information between telecommunications carriers about current or proposed customer products and services or unbundled network elements or some combination thereof.

Provisioning. "Provisioning" involves the exchange of information between telecommunications carriers where one executes a request for a set of products and services or unbundled network elements or combination thereof from the other with attendant acknowledgments and status reports.

Rural telephone company. A "rural telephone company" is a LEC operating entity to the extent that such entity:

(1) provides common carrier service to any local exchange carrier study area that does not include either:

(i) any incorporated place of 10,000 inhabitants or more, or any part thereof, based on the most recently available population statistics of the Bureau of the Census; or

(ii) any territory, incorporated or unincorporated, included in an urbanized area, as defined by the Bureau of the Census as of August 10, 1993;

(2) provides telephone exchange service, including exchange access, to fewer than 50,000 access lines;

(3) provides telephone exchange service to any local exchange carrier study area with fewer than 100,000 access lines; or

(4) has less than 15 percent of its access lines in communities of more than 50,000 on February 8, 1996.

Service control point. A "service control point" is a computer database in the public switched network which contains information and call processing instructions needed to process and complete a telephone call.

Service creation environment. A "service creation environment" is a computer containing generic call processing software that can be programmed to create new advanced intelligent network call processing services.

Signal transfer point. A "signal transfer point" is a packet switch that acts as a routing hub for a signaling network and transfers messages between various points in and among signaling networks.

State commission. A "state commission" means the commission, board, or official (by whatever name designated) which under the laws of any State has regulatory jurisdiction with respect to intrastate operations of carriers. As referenced in this part, this term may include the Commission if it assumes the responsibility of the state commission, pursuant to section 252(e)(5) of the Act. This term shall also include any person or persons to whom the state commission has delegated its authority under section 251 and 252 of the Act.

State proceeding. A "state proceeding" is any administrative proceeding in which a state commission may approve or prescribe rates, terms, and conditions including, but not limited to, compulsory arbitration pursuant to section 252(b) of the Act, review of a Bell operating company statement of generally available terms pursuant section 252(f) of the Act, and a proceeding to determine whether to approve or reject an agreement adopted by arbitration pursuant to section 252(e) of the Act.

Technically feasible. Interconnection, access to unbundled network elements, collocation, and other methods of achieving interconnection or access to unbundled network elements at a point in the network shall be deemed technically feasible absent technical or operational concerns that prevent the fulfillment of a request by a telecommunications carrier for such interconnection, access, or methods. A determination of technical feasibility does not include consideration of economic, accounting, billing, space, or site concerns, except that space and site concerns may be considered in circumstances where there is no possibility of expanding the space available. The fact that an incumbent LEC must modify its facilities or equipment to

respond to such request does not determine whether satisfying such request is technically feasible. An incumbent LEC that claims that it cannot satisfy such request because of adverse network reliability impacts must prove to the state commission by clear and convincing evidence that such interconnection, access, or methods would result in specific and significant adverse network reliability impacts.

Telecommunications. The term "telecommunications" means the transmission, between or among points specified by the user, of information of the user's choosing, without change in the form or content of the information as sent and received.

Telecommunications carrier. A "telecommunications carrier" is any provider of telecommunications services, except that such term does not include aggregators of telecommunications services (as defined in section 226 of the Act). A telecommunications carrier shall be treated as a common carrier under the Act only to the extent that it is engaged in providing telecommunications services, except that the Commission shall determine whether the provision of fixed and mobile satellite service shall be treated as common carriage. This definition includes CMRS providers, interexchange carriers (IXCs) and, to the extent they are acting as telecommunications carriers, companies that provide both telecommunications and information services. Private Mobile Radio Service providers are telecommunications carriers to the extent they provide domestic or international telecommunications for a fee directly to the public.

Telecommunications equipment. The term "telecommunications equipment" means equipment, other than customer premises equipment, used by a carrier to provide telecommunications services, and includes software integral to such equipment (including upgrades).

Telecommunications service. The term "telecommunications service" means the offering of telecommunications for a fee directly to the public, or to such classes of users as to be effectively available directly to the public, regardless of the facilities used.

Telephone exchange service. The term "telephone exchange service" means (A) service within a telephone exchange, or within a connected system of telephone exchanges within the same exchange area operated to furnish to subscribers intercommunicating service of the character ordinarily furnished

by a single exchange, and which is covered by the exchange service charge, or (B) comparable service provided through a system of switches, transmission equipment, or other facilities (or combination thereof) by which a subscriber can originate and terminate a telecommunications service.

Telephone toll service. The term "telephone toll service" means telephone service between stations in different exchange areas for which there is made a separate charge not included in contracts with subscribers for exchange service.

Virtual collocation. "Virtual collocation" is an offering by an incumbent LEC that enables a requesting telecommunications carrier to:

(1) designate or specify equipment to be used for interconnection or access to unbundled network elements to be located within or upon an incumbent LEC's premises, and dedicated to such telecommunications carrier's use;

(2) use such equipment to interconnect with an incumbent LEC's network facilities for the transmission and routing of telephone exchange service, exchange access service, or both, or for access to an incumbent LEC's unbundled network elements for the provision of a telecommunications service; and

(3) electronically monitor and control its communications channels terminating in such equipment.

SECTION IV

PART I

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF ALBERT E. WOOD, JR.

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Albert E. Wood, Jr. My business address is 545 E. John Carpenter Freeway, Irving, TX, 75062.

Q. ARE YOU THE SAME ALBERT E. WOOD, JR. WHO FILED DIRECT TESTIMONY IN DOCKET 960847-TP, THE ARBITRATION BETWEEN AT&T AND GTE?

A. Yes, that Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony presented GTE's positions on the open issues between it and AT&T with regard to AT&T's requests for unbundled elements and wholesale services.

Q. DOES MCI'S PETITION PRESENT ESSENTIALLY THE SAME ISSUES AS AT&T'S?

A. Yes, I believe MCI and AT&T have requested fundamentally the same level of unbundling and terms for wholesale provision of network elements. The same principles covered in my Direct Testimony in the AT&T proceeding thus apply equally to MCI. For that reason, it would

be unduly repetitive to submit wholly new testimony in this MCI arbitration. I am thus adopting my Direct Testimony in the AT&T arbitration as my Direct Testimony in this MCI arbitration. This approach is consistent with the Commission's consolidation of the two arbitration dockets into a single proceeding. If there are any outstanding MCI-specific issues or positions, I will address them in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes.

PART II

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF DOUGLAS N. MORRIS

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Douglas N. Morris. My business address is 600 Hidden Ridge, Irving, TX, 75038.

Q. ARE YOU THE SAME DOUGLAS N. MORRIS WHO FILED DIRECT TESTIMONY IN RESPONSE TO AT&T'S ARBITRATION PETITION IN DOCKET 960847-TP?

A. Yes. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony presented GTE's position on unbundling of Signaling System 7 (SS7), in response to AT&T's Petition for Arbitration.

Q. DO THE AT&T AND MCI PETITIONS FOR ARBITRATION RAISE ESSENTIALLY THE SAME ISSUES WITH REGARD TO SS7 UNBUNDLING?

A. Yes, I believe they do. Because fundamentally the same issues are presented by both Petitions, I don't believe wholly new testimony with regard to MCI is warranted. In an effort to avoid undue repetition, I am adopting my Direct Testimony in the AT&T arbitration as my Direct

Testimony in this MCI arbitration as well. This approach is consistent with the Commission's consolidation of these dockets for hearing and resolution in a single proceeding. If there are MCI-specific issues and positions that need to be addressed, I will do so in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART III

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF MICHAEL L. DELLANGELO

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Michael L. DellAngelo. My business address is 600 Hidden Ridge, Irving, TX, 75038.

Q. ARE YOU THE SAME MICHAEL L. DELLANGELO WHO SUBMITTED DIRECT TESTIMONY IN RESPONSE TO AT&T'S ARBITRATION PETITION IN DOCKET 960847-TP?

A. Yes. That Testimony was submitted on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony explained GTE's position on unbundling the Advanced Intelligent Network (AIN), in the context of AT&T's arbitration request for such unbundling.

Q. HAVE AT&T AND MCI RAISED SIMILAR ISSUES WITH REGARD TO AIN UNBUNDLING?

A. Yes. I believe the two companies' requests for AIN unbundling are fundamentally the same. GTE's position in response to the respective companies will thus be the same. For this reason, it would be unduly repetitive to submit wholly new testimony with regard to

MCI, particularly since the AT&T and MCI arbitration dockets have been consolidated for hearing and resolution. I am therefore adopting my Direct Testimony in the AT&T arbitration as my Direct Testimony in this MCI arbitration. If there are any MCI-specific issues and positions that must be addressed, I will do so in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART IV

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF WILLIAM E. MUNSELL

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is William E. Munsell. My business address is 600 Hidden Ridge, Irving, TX, 75038.

Q. ARE YOU THE SAME WILLIAM E. MUNSELL WHO FILED DIRECT TESTIMONY IN GTE'S RESPONSE TO AT&T'S PETITION FOR ARBITRATION IN DOCKET 960847-TP?

A. Yes, I am. That Testimony was filed on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. That Testimony discussed the interconnection, transport and termination requirements under the Telecommunications Act of 1996 and set forth GTE's position on how it would comply with these requirements in response to AT&T's Petition for Arbitration.

Q. HAVE AT&T AND MCI RAISED ESSENTIALLY THE SAME ISSUES IN THEIR RESPECTIVE PETITIONS FOR ARBITRATION?

A. Yes, I believe the two companies have presented fundamentally the same issues for resolution through arbitration. As such, my Direct Testimony in response to A&T makes the same points GTE needs to

make in its direct case in this MCI arbitration. For this reason, I adopt that testimony as my Direct Testimony in this case. This approach, I believe, avoids undue repetition and is consistent with the Commission's consolidation of the AT&T and MCI Petitions into a single proceeding. If there are any MCI-specific issues and positions that must be addressed, I will do so in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR DIRECT TESTIMONY?

A. Yes, it does.

PART V

GTE FLORIDA INCORPORATED

DIRECT TESTIMONY OF JOHN W. RIES

DOCKET NO. 960980-TP

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is John W. Ries. My business address is 600 Hidden Ridge, Irving, TX, 75038.

Q. ARE YOU THE SAME JOHN W. RIES WHO SUBMITTED DIRECT TESTIMONY FOR GTE IN ITS RESPONSE TO AT&T'S PETITION FOR ARBITRATION IN DOCKET 960847-TP?

A. Yes, I submitted that Testimony on September 10, 1996.

Q. WHAT WAS THE PURPOSE OF THAT EARLIER-FILED TESTIMONY?

A. It described the collocation requirements under the Telecommunications Act of 1996 (Act) and presented GTE's position on the collocation issues that have been contentious in GTE's negotiations with AT&T.

Q. ARE MOST OF THOSE SAME ISSUES RAISED BY MCI'S PETITION FOR ARBITRATION?

A. Yes, I believe that the respective Petitions for Arbitration of AT&T and MCI present fundamentally the same collocation issues. GTE's response to these two companies will thus be essentially the same.

For this reason, I am adopting my testimony in the AT&T arbitration as my testimony in this arbitration with MCI. This approach avoids undue repetition, and is consistent with my understanding that the Commission has consolidated the MCI and AT&T proceedings. To the extent that there are any MCI-specific issues and positions that must be addressed, I will do so in my Rebuttal Testimony.

Q. DOES THAT CONCLUDE YOUR TESTIMONY?

A. Yes, it does.