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**REBUTTAL TESTIMONY OF  
ART LERMA  
ON BEHALF OF AT&T COMMUNICATIONS  
OF THE SOUTHERN STATES, INC.  
BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION**

Docket No. 960847-TP

Filed: September 24, 1996

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

A. My name is Art Lerma and my business address is Promenade I, Room 5082, 1200 Peachtree Street, Atlanta, GA. 30309.

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

A. I am employed by AT&T as Area Controller-Regional Controller Organization.

**Q. DID YOU FILE TESTIMONY PREVIOUSLY IN THIS DOCKET?**

A. Yes. I addressed the determination of wholesale prices for GTE's Florida services subject to resale through the presentation of an avoided cost study.

**Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

A. In response to the avoided cost studies submitted by GTE, which produce unreasonably low percentage discounts applicable to retail rates, I will discuss the AT&T simplified avoided cost ("ASAC") study which complies with both the Telecommunications Act of 1996 ("the Federal Act") and regulations regarding

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1 wholesale prices for services subject to resale as set forth in the FCC's Order released  
2 August 8, 1996 (the "FCC Order"). The ASAC study results in a recommended  
3 permanent percentage reduction of 36.15% which would apply uniformly to all  
4 Florida retail local, toll, and private line GTE retail services rates. GTE presented  
5 two studies which produce composite discounts of 7.00% and 11.25% respectively.  
6 This study demonstrates the insufficiency of the avoided cost discounts proposed by  
7 GTE in this case.

8

9 I will respond to the direct testimony of GTE witness Douglas E. Wellemeyer.  
10 Specifically I will address GTE's Avoided Cost Study ("Original Study") discussed  
11 by Mr. Wellemeyer in his testimony. I will also address GTE's Modified Avoided  
12 Cost Study ("Modified Study") which was also discussed in his testimony. Mr.  
13 Wellemeyer states that the Modified Study was prepared by GTE "in conformance  
14 with Part 51 Rules, for use if the Rules are determined to be lawful."

15

16 **Q. WHAT ARE THE CRITERIA SET FORTH BY THE FCC, FOR USE IN**  
17 **DETERMINING THE WHOLESALE PRICE FOR SERVICES SUBJECT**  
18 **TO RESALE?**

19 **A.** Generally, the FCC determined that wholesale prices should equal retail rates less  
20 avoided retail costs. The FCC requires that avoided costs be established by a cost  
21 study that considers the following pertinent criteria:

22

23 1. "that 'the portion [of the retail rate] . . . attributable to costs that will be  
24 avoided' includes all of the costs that the LEC incurs in maintaining a retail, as  
25 opposed to a wholesale, business." FCC Order, ¶ 911;

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2. "an avoided cost study must include indirect, or shared, costs as well as direct costs." FCC Order, ¶ 912;
3. "[a] portion of contribution, profits, or markup may also be considered 'attributable to costs that will be avoided' when services are sold wholesale." FCC Order, ¶ 913;
4. "[a]n avoided cost study may not calculate avoided costs based on non-cost factors or policy arguments." FCC Order, ¶ 914;
5. "precludes use of a 'bottom up' TSLRIC study to establish wholesale rates that are not related to the rates for the underlying retail services." FCC Order, ¶ 915;
6. "[w]e neither prohibit nor require use of a single, uniform discount rate for all of an incumbent LEC's services." FCC Order, ¶ 916;
7. According to the FCC Order, the direct costs in the following Uniform System of Accounts ("USOA") accounts are presumed avoidable:
  - 6611-product management
  - 6612-sales
  - 6613-product advertising
  - 6621-call completion services
  - 6622-number services (also referred to as directory assistance)

1 • 6623-customer services (including billing and collection costs).

2

3 GTE may rebut the presumption of avoidance by showing costs will be  
4 incurred for wholesale activities or that the costs are not in the retail price. FCC  
5 Order, ¶ 917;

6

7 8. Under the FCC Order, ¶ 918, indirect expenses in the following USOA  
8 accounts are presumed to be avoided in proportion to the avoided direct  
9 expenses:

- 10 • 6121 to 6124-general support expenses
- 11 • 6711, 6712, and 6721 to 6728-corporate operations expenses
- 12 • 5301-telecommunications uncollectibles.

13

14 9. “[p]lant-specific and plant non-specific expenses (other than general support  
15 expenses) are presumptively not avoidable.” FCC Order, ¶ 919. The new  
16 entrant may rebut the presumption by showing that any of those costs can be  
17 reasonably avoided; and

18

19 10. “based on the record before us, we establish a range of default discounts of 17-  
20 25% that is to be used in the absence of an avoided cost study that meets the  
21 criteria set forth above.” FCC Order, ¶ 932.

22

23 **Q. HAVE YOU PERFORMED A COST STUDY THAT COMPLIES WITH THE**  
24 **FCC RULES FOR DETERMINING AVOIDED COSTS?**

25 **A.** Yes. The ASAC study provided as Attachment ALR-1 with accompanying

1 workpapers provided as Attachment ALR-2 reflects avoided costs for GTE based  
2 upon the FCC rules.

3

4 **Q. WHAT PERCENTAGE REDUCTION FACTOR IS PRODUCED BY THE**  
5 **ASAC STUDY?**

6 A. The study produces a percentage reduction of 36.15% applicable to all of GTE's  
7 retail rates in Florida.

8

9 **Q. PLEASE SUMMARIZE HOW AT&T DETERMINED THE AMOUNT OF**  
10 **GTE RETAIL COSTS THAT SHOULD BE EXCLUDED FROM RETAIL**  
11 **RATES.**

12 A. The ASAC study identifies costs and revenues associated with retail activities in the  
13 combined local, toll and private line services market. The end result is a percentage  
14 that should be used to uniformly reduce GTE's local, toll and private line services  
15 retail rates in order to reflect all relevant retail costs avoided.

16

17 **Q. WHY ARE ACCESS AND MISCELLANEOUS REVENUES AND AVOIDED**  
18 **COSTS EXCLUDED FROM THE CALCULATION OF THE WHOLESALE**  
19 **DISCOUNT FACTOR?**

20 A. According to the FCC Interconnection Rules, 47 C.F.R. § 51.1 *et seq.* ("FCC  
21 Rules"), issued in conjunction with the FCC Order:

22 [a]n incumbent LEC shall offer to any requesting  
23 telecommunications carrier any telecommunications service that the  
24 incumbent LEC offers on a retail basis to subscribers that are not  
25 telecommunications carriers for resale at wholesale rates that are at

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the election of the state commission. 47 C.F.R. § 51.605(a).

Access services, as referenced in the FCC Rules (see 47 C.F.R. § 51.607), and miscellaneous services, such as rental of space in conduit and pole line space for attachments, are not generally offered to “subscribers that are not telecommunications carriers” and are therefore excluded from the ASAC study. The methodology to accomplish the identification of avoided access and miscellaneous costs is provided on page 3 of Attachment ALR-2. Because access and miscellaneous avoided retail costs are excluded from the calculation, access and miscellaneous revenues are not reflected in the calculation of the revenues subject to resale.

**Q. UPON WHAT AVAILABLE DATA DOES THE ASAC STUDY RELY?**

A. The ASAC study relies upon the Automated Reports Management Information System (“ARMIS”) reports that GTE filed with the FCC for 1995. The specific data that AT&T uses is primarily obtained from the ARMIS 43-03 (Joint Cost Report). This report provides the regulated annual operating results of GTE for every account in the FCC's Part 32 Rules. Data from the ARMIS 43-04 (Access Report) is used in the calculation of avoided depreciation expense as detailed in my Attachment ALR-2, page 2. The ARMIS 43-04 report provides regulated financial and operating data separated in accordance with Part 36 and Part 69 of the FCC’s Rules.

**Q. PLEASE DESCRIBE THE USOA ACCOUNTS SHOWN AS PRODUCING AVOIDED COSTS ON YOUR ATTACHMENT ALR-1.**

A. All USOA accounts that are presumed avoided in the FCC’s Order (FCC Order, ¶¶ 917, 918) are reflected. Also included is an amount of avoided costs pertaining to

1 return and related income taxes consistent with the FCC Order. FCC Order, ¶ 913.  
2 In addition, certain costs are reflected in the ASAC study that are not presumed  
3 avoided in the FCC Order, but which are left for state consideration. These costs are  
4 discussed later in this testimony. AT&T believes that these other costs can  
5 reasonably be avoided. Attachment ALR-1 also provides a calculation of the  
6 revenues subject to resale which in essence include all local, toll, and private line  
7 revenues. Lastly, Attachment ALR-1 provides a calculation of the avoided cost  
8 percentage reduction or discount factor.

9

10 **Q. PLEASE EXPLAIN WHAT AVOIDED COSTS, IF ANY, ARE INCLUDED**  
11 **IN THE ASAC STUDIES THAT WERE NOT SPECIFICALLY PRESUMED**  
12 **AVOIDED IN THE FCC ORDER AND RULE.**

13 **A. AT&T has included costs for USOA accounts 6220 (operator systems), 6533**  
14 **(operations testing), 6534 (operations plant administration), and 6560 (the portions of**  
15 **depreciation expense pertaining to operator systems and general support assets). The**  
16 **ASAC studies reflect those costs based on direction provided in 47 C.F.R.**  
17 **§ 51.609(d). That rule states that:**

18 [c]osts included in accounts 6110-6116 and 6210-6565 . . . may be  
19 treated as avoided retail costs and excluded from wholesale rates,  
20 only to the extent that a party proves to a state commission that  
21 specific costs in these accounts can reasonably be avoided when an  
22 incumbent LEC provides a telecommunications service for resale to a  
23 requesting carrier.

24

25 Also included in the ASAC study is a calculation of avoided return and income taxes

1 that is consistent with paragraph 913 of the FCC Order. In this paragraph, the FCC  
2 states that "in AT&T's model, the portion of return on investment (profits) that was  
3 attributable to assets used in avoided retail activities was treated as an avoided cost.  
4 We find that these approaches are consistent with the 1996 Act."

5  
6 **Q. WHY DOES THE ASAC STUDY CONSIDER COSTS FOR OPERATOR**  
7 **SYSTEMS (ACCOUNT 6220) AND A PORTION OF DEPRECIATION**  
8 **EXPENSE PERTAINING TO OPERATOR SYSTEMS (ACCOUNT 6560) AS**  
9 **AVOIDABLE?**

10 **A.** This calculation is necessary and consistent with two other categories of costs that are  
11 presumed avoided in the FCC Order. Specifically, those costs that are captured in  
12 accounts 6621 (call completion services) and 6622 (number services) are costs that  
13 are avoided because these are operator service-related. The FCC states that these  
14 costs are avoided "because resellers have stated they will either provide these services  
15 themselves or contract for them separately from the LEC or from third parties." FCC  
16 Order, ¶ 917. When resellers perform their own operator services, the LEC's  
17 wholesale business would not require the use of any operator systems, and likewise,  
18 GTE would incur no operator systems equipment costs (which is the definition of  
19 account 6220 per the FCC's USOA rules) in the provision of its wholesale business.  
20 Likewise, there is a component of depreciation expense pertaining to operator systems  
21 assets included in account 6560. Because this depreciation expense is related to  
22 operator systems, it too can reasonably be avoided for GTE's wholesale businesses.

23  
24 **Q. WHY DOES THE ASAC STUDY CONSIDER THE COSTS OF TESTING**  
25 **(ACCOUNT 6533) AND PLANT ADMINISTRATION (6534) AS**



1           **AVOIDABLE COSTS?**

2    A.    According to Part 32 of the FCC's USOA rules, account 6533 (testing expense)  
3           includes "costs incurred in testing telecommunications facilities from a testing facility  
4           (test desk or other testing system) to determine the condition of plant on either a  
5           routine basis or prior to assignment of the facilities; receiving, recording and  
6           analyzing trouble reports; testing to determine the nature and location of reported  
7           trouble condition; and dispatching repair persons or otherwise initiating corrective  
8           action." Account 6534 (plant administration) includes "costs incurred in the general  
9           administration of plant operations. This includes supervising plant operations;  
10          planning, coordinating, and monitoring plant operations; and performing staff work."  
11         AT&T has requested an electronic interface with GTE's service trouble reporting  
12         databases so that it can provide services at a level of quality comparable to that  
13         provided by GTE. This will allow AT&T to perform both immediate and high  
14         quality initial trouble analysis (including receiving and recording incidents when a  
15         customer reports trouble on his line). Based on AT&T's experience, about 50% of its  
16         own testing and plant administration costs involve end user customers. Based on this  
17         experience, AT&T conservatively estimates that approximately 20% of GTE's  
18         customer related testing costs can reasonably be avoided. In addition, all plant  
19         administration costs incurred in support of the customer interface portion of testing  
20         functions are impacted, so that 20% of these costs can also reasonably be avoided.

21

22    **Q.    WHY DOES THE ASAC STUDY CONSIDER DEPRECIATION EXPENSES**  
23           **PERTAINING TO GENERAL SUPPORT ASSETS (INCLUDED IN**  
24           **ACCOUNT 6560) AS AVOIDABLE COSTS?**

25    A.    Depreciable general support assets are the assets reflected in accounts 2121 through

1           2124. These accounts include costs for buildings, furniture, office equipment, and  
2           general purpose computers, respectively. Those assets that were previously used to  
3           support the retail business are not required in their entirety for the provision of GTE's  
4           wholesale business. Consequently, a portion of the depreciation expense in account  
5           6560 pertaining to these general support assets can reasonably be avoided. The  
6           portion of this depreciation cost that is avoided is calculated using the same ratio that  
7           is used to calculate other indirect costs previously mentioned.

8

9   **Q.   HOW DOES AT&T CALCULATE THE PORTION OF INDIRECT**  
10 **EXPENSES THAT ARE PRESUMED AVOIDED IN THE FCC ORDER AND**  
11 **RULES?**

12 **A.**   The ASAC study for GTE calculates a ratio of directly avoided costs to total direct  
13 costs. This ratio is then applied to indirect costs. This methodology more correctly  
14 relates the ratio of directly avoided costs to indirect costs than does the MCI  
15 methodology used by the FCC to calculate proxy wholesale rates, since it does not  
16 include the very costs for which the calculation is made to determine the avoided  
17 indirect costs. This ratio is developed by taking directly avoided costs totaling  
18 \$154,948,000 for GTE in Florida, divided by total direct costs of \$626,820,000. The  
19 ratio that results is 24.7%. The ratio that is applied to avoided return and income  
20 taxes is 3.11%. That calculation is provided on page 4 of Attachment ALR-2.

21

22 **Q.   HOW DOES AT&T TREAT UNCOLLECTIBLES?**

23 **A.**   Pursuant to the FCC Order, AT&T treats costs from account 5301  
24 (telecommunications uncollectibles) as indirect avoided costs. Unlike other indirect  
25 costs, however, AT&T's study treats end user uncollectibles as 100% avoided in a

1 resale environment, because the liability for end user uncollectibles transfers in total  
2 to the reseller.

3

4 **Q. WHAT ADJUSTMENTS, IF ANY, DID THE FCC MAKE TO THE MCI**  
5 **MODEL IN CALCULATING THE INTERIM DEFAULT RANGE THAT**  
6 **ARE NOT INCLUDED IN THE ASAC STUDY?**

7 **A.** The adjustments that are not included in the ASAC Study are as follows:

8 1. In ¶ 928 of the FCC Order, the FCC found “it reasonable to assume, *for purposes*  
9 *of determining a default range of wholesale discount rates*, that ten percent of costs  
10 in accounts 6611, 6612, 6613, and 6623 are not avoided by selling services at  
11 wholesale.” As stated in this paragraph, the 10% was selected “given the lack of  
12 evidence, and the wide range of estimates that have been made by these states.” This  
13 was done only for the purpose of calculating a proxy number for certain local  
14 exchange companies (“LECs”). Such a proxy would only be used if compliant cost  
15 studies could not be done. Because AT&T’s studies are fully compliant and because  
16 GTE has not convincingly demonstrated that the expenses in these accounts are not  
17 avoided, the studies submitted by AT&T reflect 100% of the amounts in these  
18 accounts as avoided instead of 90%.

19

20 2. In ¶ 928 of the FCC Order, the FCC discusses the approach it took to calculate the  
21 portion of indirect costs that are avoided in calculating the interim default range. As a  
22 substitute to the formulas used by MCI, the FCC used a formula based on a ratio of  
23 avoided direct expense to total expenses. However, in ¶ 918 of the FCC Order, the  
24 FCC criteria for calculating the portion of indirect costs that is presumed avoided is  
25 to be “in proportion to the avoided direct expenses.” The ASAC study utilizes a

1 formula for determining a ratio to apply to indirect costs based on avoided direct  
2 expenses to total direct expenses, thereby excluding from the denominator the indirect  
3 costs to which the ratio will be applied. This produces a more appropriate ratio, since  
4 it does not include the very expenses (indirect expenses) that are assumed to be  
5 avoided in proportion to the direct expenses avoided.

6

7 **Q. IS THE ASAC STUDY APPROPRIATE FOR THIS COMMISSION TO SET**  
8 **PERMANENT WHOLESALE RATES?**

9 A. Yes. The ASAC study was calculated consistent with the FCC's criteria for avoided  
10 cost studies necessary for setting permanent wholesale rates.

11

12 **Q. WHY IS THE ASAC STUDY CONSISTENT WITH THE FCC'S AVOIDED**  
13 **COST STUDY CRITERIA AND RULES?**

14 A. As required by the FCC Order, the ASAC study is a top-down study based on  
15 embedded costs of GTE. Second, all of the USOA cost categories that are presumed  
16 avoided in the FCC Order are treated as avoided in the ASAC study. Third, AT&T  
17 demonstrates why each cost included in the ASAC study but not presumed avoided in  
18 the FCC Order will be avoided by GTE. Finally, AT&T properly identifies costs  
19 subject to proration between retail and wholesale services.

20

21 **Q. ARE YOU FAMILIAR WITH THE COST STUDIES SUBMITTED BY GTE**  
22 **IN THIS PROCEEDING?**

23 A. Yes. I have reviewed the methodology and assumptions for both the original GTE  
24 avoided cost study and the GTE modified avoided cost study. Based on the testimony  
25 of Mr. Wellemeyer on pages 6 and 7, the Original Study produces either avoided

1 costs per line or wholesale discount rates for five separate service categories as  
2 follows:

- 3 Residential services avoided cost discount- \$.83 per line per month  
4 Business services avoided cost discount- \$1.06 per line per month  
5 Usage services- 7.1%  
6 Vertical services:  
7 Business - 5.5%  
8 Residence- 6.6%  
9 Combined- 6.2%  
10 Advanced Serv. -15.3%  
11 Composite % -7.00% (page 39 of Wellemeyer testimony)

12 GTE's Modified Avoided Cost Study produces a uniform discount of 11.25%. Both  
13 of the studies submitted by GTE produce unreasonably low avoided costs per line or  
14 discount rates.

15

16 **Q. WHAT, IF ANY, CONCERNS DO YOU HAVE WITH GTE'S ORIGINAL**  
17 **AVOIDED COST STUDY?**

18 **A.** I have several concerns including the fact that the study uses national retail cost data  
19 and units as a basis for determining avoided costs per line that are subsequently  
20 applied to BellSouth's Florida residential and business local retail rates. The same  
21 holds true for the wholesale discount rates applicable to the other three service  
22 categories included in this study.

23

24 **Q. IS THERE ANY SIGNIFICANCE TO USING THIS NATIONAL RETAIL**  
25 **COST DATA TO CALCULATE GTE'S AVOIDED COSTS FOR FLORIDA?**

1 A. Yes. The average national avoided costs calculated in this study for each service  
2 category may not be representative of the state specific costs that underlie GTE's  
3 retail telephone rates in Florida. The study is based on data from national work  
4 centers that GTE has determined as being involved in retail functions that would not  
5 be present in resale transaction. On pages 12, 13, and 14 of his testimony, witness  
6 Wellemeyer describes the fact that the study is based on data from GTE's total  
7 domestic operations assembled by workcenter.

8  
9 **Q. IN THE ORIGINAL STUDY, HOW HAS GTE TREATED THE COST**  
10 **CATEGORIES THAT THE FCC PRESUMES ARE COMPLETELY**  
11 **AVOIDED?**

12 A. For some of the marketing and customer service categories that the FCC presumes are  
13 completely avoided, only small or unreasonably low percentages of the costs are  
14 treated as avoided. This is true for accounts 6611 (product management), 6612  
15 (sales), 6622 (number services) and 6623 (customer services. For another cost  
16 category, 6621(call completion), that is also presumed completely avoided in the FCC  
17 Order, this study produces zero avoided costs. I have prepared Attachment No. ALR-  
18 3, which compares as a percentage of the total regulated costs for each account the  
19 amount for each of these accounts that was treated as avoided by GTE. ALR-3 is  
20 filed under proprietary cover because the entire set of workpapers underlying GTE's  
21 original cost study was submitted as proprietary.

22  
23 In addition, there are no indirect costs (general and administrative costs, corporate  
24 operations costs, or general support costs) included in this study. This is clearly  
25 contrary to the FCC's Order at paragraph 918.

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**Q. HAS GTE CONSIDERED ANY NON-COST FACTORS OR POLICY ARGUMENTS IN ITS ORIGINAL AVOIDED COST STUDY?**

A. Yes. For instance, on page 27 of his direct testimony, Mr. Wellemeyer refers to the fact that the calculation of the wholesale rates for the residential and business access line service categories includes adjustments for what GTE refers to as representing “foregone contribution associated with complementary services such as from intraLATA toll service.” This “foregone contribution” is apparently offset by gains from access contribution. Mr. Wellemeyer explains that his treatment of contribution is determined using pricing rules proposed by GTE's witness Sibley. However, this type of adjustment is not contemplated in the FCC Order which specifically states in paragraph 914 that “an avoided cost study may not calculate avoided costs based on non-cost factors or policy arguments, nor may it make disallowances for reasons not provided for in section 252(d)(3).” In addition, GTE’s reasons for excluding services from revenues subject to resale amount to policy arguments, which are discussed later in my testimony.

**Q. DOES GTE’S CALCULATION OF AVOIDED COSTS REFLECT ADDITIONAL COSTS THAT GTE BELIEVES WILL BE INCURRED IN A WHOLESALE ENVIRONMENT?**

A. Yes, in calculating the wholesale discount percentage, GTE adjusts the calculations primarily for what it considers will be offsetting wholesale costs based on the costs it incurs in providing access service to the IXCs today. On page 22 of Mr. Wellemeyer’s testimony, he refers to this second component of avoided retail costs as substitute retail costs. He states beginning on line 3 that “[s]ince retail services have

1 not yet been offered for resale for any length of time, their substitute costs cannot be  
2 measured directly. Instead, GTE's substitute costs associated with offering service  
3 on a wholesale, rather than a retail basis, were calculated by determining the affected  
4 costs of an existing wholesale service similar in nature to the service to be offered at  
5 resale." Continuing on pages 22 and 23, Mr. Wellemeyer describes the proxies that  
6 were used based on the current wholesale provision of access services. For vertical  
7 services, Mr. Wellemeyer on page 26 states that "GTE was unable to identify an  
8 existing service whose costs would approximate the cost of providing vertical  
9 features." Instead, GTE applied avoided cost relationships associated with basic  
10 exchange services.

11

12 Thus, Mr. Wellemeyer's methodology to identify new recurring wholesale costs is  
13 flawed because of a lack of direct cost measurements. Additionally, the percentages  
14 of substitute costs that result are unreasonable. Based on the avoided cost results  
15 provided on page 25 of Mr. Wellemeyer's direct testimony, these substitute cost  
16 offsets represent as much as 41% of the current retail costs that are being avoided  
17 and, accordingly, are poor proxies for this exercise. Where access costs are used as a  
18 proxy for substitute retail costs, it is difficult to accept that any retail functions  
19 performed in the provision of access service involve such a high level of costs.

20

21 **Q. WHAT ARE YOUR CONCERNS WITH GTE'S MODIFIED AVOIDED**  
22 **COST STUDY?**

23 **A.** All of the same concerns that I have with GTE's Original Study are also applicable to  
24 the Modified Study. Mr. Wellemeyer states on page 35 of his testimony that "the  
25 study was based on the same workcenter cost detail used in GTE's Avoided Cost



1 Study." Next, on page 36, Mr. Wellemeyer considers no avoided costs for the entire  
2 public service category which includes services that are not excluded from resale per  
3 the Federal Act. Mr. Wellemeyer also states on pages 37 and 38 that there are no  
4 avoided costs included in this study for operator services expenses or for product  
5 management expenses. Clearly, these are accounts that are presumed avoided in the  
6 FCC Order and will be avoided in a wholesale environment.

7

8 **Q. HAS GTE APPROPRIATELY CALCULATED THE PORTION OF**  
9 **INDIRECT COSTS THAT IS AVOIDED PER THE FCC ORDER?**

10 **A.** No. In the Modified Study, GTE has used an inappropriate formula to determine the  
11 percentage of indirect costs that are attributable to avoided direct retail costs. This is  
12 based on a ratio of directly avoided costs to total costs. The FCC's criteria for cost  
13 studies provide that indirect costs "are presumed to be avoided in proportion to the  
14 avoided direct expenses." FCC Order, ¶ 918. The ratio should be based on directly  
15 avoided costs divided by total direct costs. This is appropriate because it is not  
16 reasonable to include in the denominator the same expenses to which the ratio will be  
17 applied. In the ASAC study this correct calculation produced a ratio of 24.7%.  
18 Furthermore, because of the low amounts of directly avoided costs calculated by GTE  
19 in its study, the inclusion of indirect costs in the denominator results in an even  
20 smaller amount of indirect costs as avoided.

21

22 **Q. IS IT INAPPROPRIATE TO EXCLUDE SERVICES FOR RESALE ON A**  
23 **CLAIM THAT CURRENT RATES ARE BELOW COST?**

24 **A.** Yes. Paragraph 956 of the FCC Order states that "we believe that below-cost  
25 services are subject to the wholesale rate obligation under section 251(c) (4)." Also

1            “[t]he resale pricing standard gives the end user the benefit of an implicit subsidy in  
2            the case of below-cost service, whether the end user is served by the incumbent or by  
3            a reseller, just as it continues to take the contribution if the service is priced above  
4            cost.” On pages 40 and 41 of his testimony, Mr. Wellemeyer provides policy  
5            arguments to justify the services GTE proposes to include from resale. As stated  
6            previously, paragraph 914 of the Act expressly prohibits the inclusion of policy  
7            arguments in an avoided cost study.

8

9    **Q.    HAS GTE IMPROPERLY EXCLUDED ANY SERVICES FROM THE**  
10    **CALCULATION OF REVENUES SUBJECT TO RESALE?**

11    **A.    Yes.** On page 39 of his testimony, Mr. Wellemeyer provides the list of services that  
12    GTE does not plan to offer for resale. These include: below cost services,  
13    promotional services, services offered at wholesale today (e.g., access and private line  
14    services offered primarily to carriers), grandfathered services, discounted calling  
15    plans, AIN services, non-recurring charge services, pay phone lines, semi-public pay  
16    phone lines, and COCOT coin and coinless lines. According to the Federal Act and  
17    FCC Order, GTE must make available any telecommunications service provided on a  
18    retail basis to subscribers that are not telecommunications carriers. The only  
19    restrictions on resale are those as noted in Rule 51.613 of the Order.

20

21    **Q.    WHY SHOULD WE BE CONCERNED WITH THE LOW DISCOUNTS**  
22    **PRODUCED BY THE GTE STUDIES?**

23    **A.    If** wholesale prices are set higher than are justified based on avoided retail costs,  
24    consumers will have less competitive choices because some resellers will not be able  
25    to effectively compete with the incumbent LEC.

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**Q. IF THE COMMISSION WERE TO DECLINE TO IMPOSE A PERMANENT DISCOUNT BASED ON AN AVOIDED COST STUDY AT THIS TIME, WHAT WOULD YOU RECOMMEND THE COMMISSION DO?**

A. Available and readily verifiable cost data in the avoided cost study filed by AT&T in this proceeding support a retail cost reduction well above the maximum default rate of 25%. The FCC Order authorizes states to establish interim wholesale discounts within a default range of 17-25%. I would recommend an interim retail cost reduction at the highest end of that range--a 25% interim cost reduction.

**Q. WOULD YOU PLEASE SUMMARIZE AT&T'S RECOMMENDATIONS IN THIS PROCEEDING?**

A. Yes. Because neither of GTE's studies comply with the Federal Act or the FCC Order, AT&T recommends that permanent wholesale rates for GTE services subject to resale be based upon a uniform wholesale discount percentage of 36.15%. In support of this permanent wholesale discount, AT&T has presented the ASAC study as Attachment ALR-1. In addition, AT&T also presented workpapers supporting the ASAC study as Attachment ALR-2.

**Q. HAVE YOU REVIEWED THE FLORIDA SPECIFIC GTE COST STUDIES THAT MR. WELLEMAYER REFERENCES IN HIS TESTIMONY?**

A. No. AT&T has not yet received copies of the cost studies GTE prepared for Florida. Therefore, I have based my analysis on the methodology GTE has been using in its nationwide cost studies. Most recently, I reviewed the cost studies that GTE filed in Texas. If the Florida specific costs studies produce different results that may alter the

1 results of my calculations, I reserve the right to supplement my testimony to reflect  
2 the Florida specific cost studies.

3 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

4 **A. Yes it does.**

1995 GTE  
STATE OF FLORIDA  
THE AT&T SIMPLIFIED AVOIDED COST STUDY  
(\$000's)

ACCOUNT	CATEGORY	AMOUNT
<b>AVOIDED DIRECT COSTS</b>		
6610	Marketing	\$35,325
6620	Service Expense	\$97,866
6220	Operator Systems Expense	\$4,462
6533	Operations Testing	\$4,457
6534	Operations Plant Administration	\$3,920
6560 (a)	Depreciation - Operator Systems Costs	\$11,338
-----	Less - Access Costs	\$2,420
<b>TOTAL DIRECT AVOIDED COSTS</b>		<b>\$154,948</b>
<b>AVOIDED INDIRECT COSTS</b>		
5301	Uncollectible Expense	\$18,946
6120	General Support	\$23,182
6560 (b)	Depreciation - General Support	\$7,740
6710	Executive and Planning	\$1,956
6720	General & Administrative	\$37,963
-----	Return and Income Taxes	\$11,096
-----	Less - Misc. Costs	\$4,023
<b>TOTAL INDIRECT AVOIDED COSTS</b>		<b>\$96,860</b>
<b>TOTAL AVOIDED COSTS</b>		<b>\$251,808</b>
<b>REVENUE BASE FOR AVOIDED COST CALCULATION</b>		
5001 - 5069	Basic Local Service (INCLUDES PRIVATE LINE)	\$615,646
5100 - 5169	Long Distance Services (INCLUDES PRIVATE LINE)	\$80,825
<b>TOTAL REVENUES SUBJECT TO RESALE</b>		<b>\$696,471</b>
<b>AVOIDED DISCOUNT FACTOR</b>		<b>36.15%</b>
(Total Avoided Costs / Revenues Subject to Resale)		

**Calculation of Return and Taxes  
On Avoided General Support and Operator System Investment**

	<u>Line #</u>	<u>Amount</u>		
	<u>43-04</u>	<u>Sub sep</u>		
Operator Systems	1170	24,468		
General Support	1004	<u>447,847</u>		
Total Oper Sys & Gen'l Support Plant		<u>472,315</u>		
Total Equal Access Property	30	-		
Total Telecomm Plant in Svc	2194	<u>3,759,263</u>		
Total Plant in Service		<u>3,759,263</u>		
% Oper Sys & Gen'l Supp/Total		12.56%	(A)	
<u>Return @ 11.25%</u>				
Average Net Investment	8040	2,064,179		
Return		232,220	3.11%*	7,212
			11.25% % Authorized	
FIT GROSS-UP DATA		7,212	53.85%**	3,884
				<b>11,096</b>

\* General Support & Operator Systems / Total Plant in Service (A)  
times applicable Indirect Avoided Cost Ratio

\*\* Factor = (1 / (1 - 0.35)) \* 0.35

Avoided Retail Percent
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Marketing Expenses

- 6611 Product Management
- 6612 Sales
- 6613 Product Advertising

Customer Service Expenses

- 6621 Call Completion Services
- 6622 Number Services
- 6623 Customer Service

DATA FROM GTE AVOIDED COST STUDY WORKPAPERS.

THIS EXHIBIT CONTAINS INFORMATION THAT  
IS DEEMED CONFIDENTIAL BY GTE FLORIDA