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October 3, 1996

VIA AIRBORNE

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

Re: Petition of Sprint Communications Company Limited Partnership for Arbitration of Proposed Interconnection Agreement with GTE Florida Incorporated, Pursuant to the Telecommunications Act of 1996

Dear Ms. Bayo:

Please find enclosed for filing, an original and fifteen (15) copies of the prefiled direct testimony of Tony H. Key and David E. Stahly on behalf of Sprint Communications Company Limited Partnership in the above proceeding. We are also enclosing a 3 1/2" diskette, in microsoft word format.

We are enclosing an extra copy of this transmittal letter. We ask that you please acknowledge receipt thereon and return to the undersigned in the enclosed, stamped and self-addressed envelope.

All parties of record have been served in accordance with the attached Certificate of Service. Thank you for your assistance.

Sincerely,

Benjamin W. Fincher

BWF/lk

cc: Everett Boyd
Parties of record

CERTIFICATE OF SERVICE

I hereby certify that I have this day served a true and exact copy of the within and foregoing Prefiled Testimony of Tony H. Key and David E. Stahly on behalf of Sprint Communications Company Limited Partnership via Express overnight mail (Airborne), to the following:

GTE Florida Incorporated
Anthony P. Gillman, Esq.
M. Eric Edington, Esq.
One Tampa City Center
201 North Franklin Street
Tampa, FL 33602

This 3rd day of October, 1996

Lorraine Kowalski

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

In the matter of:

Petition of Sprint Communications Company Limited	)	
Partnership for Arbitration of Proposed Interconnection	)	Docket No. 961173
Agreement with GTE Florida Incorporated	)	Filed October 4, 1996
Pursuant to the Telecommunications Act of 1996	)	

DIRECT TESTIMONY

OF

DAVID E. STAHLY

ON BEHALF OF

SPRINT COMMUNICATIONS COMPANY

LIMITED PARTNERSHIP

OCTOBER 4, 1996

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF

DAVID E. STAHLY

ON BEHALF OF

SPRINT COMMUNICATIONS COMPANY LIMITED PARTNERSHIP

Q. Please state your full name and business address.

A. My name is David E. Stahly. My office address in 8140 Ward Parkway, Kansas City, Missouri, 64114.

Q. What is your position?

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

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

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

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

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

My current responsibilities include coordinating with representatives of Sprint business units regarding regulatory matters, contributing to the development of Sprint regulatory policy, and testifying on behalf of Sprint concerning economic and regulatory policy in telecommunications. I have testified before the Arkansas Public Service Commission, the Georgia Public Service Commission, the Oklahoma Corporation Commission, and the Washington Utility and Transportation Commission.

Q. What is the purpose of your testimony?

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

I. TELRIC-based Pricing Methodology

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

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

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

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

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

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

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

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

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

- Prices for interconnection and unbundled elements should be developed using the TELRIC-based pricing methodology established by the FCC.

- The level of contribution to common costs should be a uniform loading that is limited to a level that reflects the common costs of an economically efficient local exchange carrier.

- The reasonable profit level to be included in TELRIC should be the most recent authorized intrastate rate of return or prescribed interstate rate of return.

- Prices for network elements should be geographically deaveraged; for example, according to high cost, medium cost, and low cost areas.

(B) TSLRIC

Q. Please explain what is meant by TSLRIC?

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

[1] William J. Baumol, Superfairness 113 (1986).

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

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

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

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

(C) TELRIC

Q. Is TSLRIC costing different from TELRIC costing?

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

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

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

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

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

b) Incremental costs of shared facilities and operations.

II. A reasonable allocation of common costs

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

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

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

1) Will include the long run, incremental costs caused by or directly attributable to the specific element. This will include both costs caused by facilities and operations dedicated to the element and those facility and operations costs shared by a group of elements.
2) Will reflect per-unit costs derived from total costs using reasonable, accurate fill factors.
3) Will reflect current wire center location and the most efficient technology available.
4) Will include a reasonable return on investment, e.g. profit.
5) Will reflect economic depreciation rates.

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

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

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

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

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

(D) Common Costs

Q. What are common costs?

A. Common costs are one type of shared cost. Shared costs are costs that are:

- » shared by more than one service;
- » incremental to a set of services sharing the costs; and
- » unaffected by any subset of the services sharing the costs

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

There are two basic types of shared costs:

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

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

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

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

(E) Contributions to Common Costs

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

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

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

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

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

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

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

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

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

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

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

Q. Please explain the business perspective.

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

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

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

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

Q. Please explain the economic perspective.

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

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

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

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

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

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

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

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

[6] Pappas & Hirschey, Managerial Economics 573-84 (1990).

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

Q. Has Sprint reviewed any measures of common costs?

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

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

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

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

(F) Return on Investment

Q. Please describe cost of capital?

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

Q. Is cost of capital part of TELRIC?

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

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

[8] Pappas & Hirschey, Managerial Economics, 10, 652-3 (1990).

Q. Does TELRIC include profit?

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

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

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

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

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

(G) Other TELRIC Considerations

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

(H) Geographic Deaveraging

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

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

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

Q. Why is this important?

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

II. Interconnection and Access to Unbundled Network Elements

(A) Summary of Position

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

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

(B) Default Prices

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

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

Element	Rate
Local Loops	$16.71
Local Switching	$0.003 per minute
Dedicated Transport	Tariffed interstate entrance facility and direct-trunked transport charges
Common Transport	Weighted average per minute equivalent of dedicated transport rate (as described in FCC 51.513(c)(4))
Tandem Switching	$0.0015 per minute
Collocation	Tariffed interstate expanded-interconnection charges
Signaling, call-	Tariffed interstate charges where available

related databases

Q. Why is it important to establish interim prices?

A. Sprint encourages the Commission to undertake and conclude proceedings to establish permanent rates under the TELRIC-based pricing methodology as quickly as possible. However, to the extent that cost studies that satisfy the criteria of the Act and FCC Order have not been developed and provided for thorough review, the interim prices provide a means for establishing interconnection and accessing network elements without delay.

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

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

III. Reciprocal Compensation Arrangements

(A) Summary of Position

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

A. No.

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

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

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

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

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

(1) Pricing

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

(2) Definition of Local Traffic

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

(3) Other Considerations

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

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

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

(B) Developing Cost-Based Rates

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

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

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

Q. Which option should the commission choose?

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

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

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

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

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

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

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

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

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

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

(C) Definition of Local Traffic

Q. How does the FCC order define local traffic?

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

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

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

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

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

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

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

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

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

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

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

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

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

Q. Are symmetrical rates appropriate?

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

transport and termination prices as a presumptive proxy for other telecommunications carriers' additional costs of transport and termination."

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

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

Q. Why should the Commission quickly establish interim rates for reciprocal compensation?

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

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

Q. Please summarize your recommendations for the commission.

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

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

IV. Wholesale Pricing for Resale

(A) Summary of Position

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

A. No.

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

A. Section 252(d)(3) states that wholesale rates should be determined "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."

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

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

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

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

(B) Avoided Cost Study - Methodology

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

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

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

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

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

A. As a LEC provides fewer retail services and more wholesale services, it is reasonable to expect that the LEC can avoid the general and administrative overhead and general support costs that are currently used to support the LEC's enormous retail operations today. In paragraph 912 of the FCC's 96-98 Order, the FCC stated:

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

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

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

(C) Wholesale Rate Categories

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

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

Q. How many categories of service do you recommend?

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

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

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

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

(D) Benefits of Correctly Determining Wholesale Rates

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

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

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

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

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

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

Q. Will wholesale rates fairly compensate the ILECs?

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

(E) Proxy Wholesale Rates

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

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

Q. What is the appropriate default wholesale discount rate?

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

(Note: Paragraph 930 of the Order sets forth the following discount rates.)

US West	18.80%
GTE	18.81%
BellSouth	19.20%
Bell Atlantic	19.99%
SBC	20.11%
NYNEX	21.31%
Pacific	23.87%
Ameritech	25.98%

V. Parity Pricing Issues

(A) Volume Discounts

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

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

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

A. Yes. The FCC found that the term "nondiscriminatory", as used throughout section 251 of the Act, applies to the terms and conditions an incumbent LEC imposes on third parties as well as itself and that by providing interconnection to a competitor in a manner less efficient than an incumbent LEC provides itself, the incumbent LEC violates the duty to be "just" and "reasonable" under section 251(c)(2)(D) (paragraph 213). With respect to volume pricing, the FCC indicated that volume discounts should correspond to cost differences of selling in large volumes. Specifically, the FCC noted that in calculating the proper wholesale rate, incumbent LECs may prove that their avoided costs differ when selling in large volumes (paragraph 953).

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

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

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

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

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

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

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

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

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

(B) Non-Recurring Charges

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

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

Q. What should Sprint's position be adopted?

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

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

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

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

(C) Interim Number Portability

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

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

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

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

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

Q. Why should Sprint's position be adopted?

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

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

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

(D) Application of Cost-Based Pricing - Miscellaneous

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

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

Q. What is GTE's position?

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

Q. Why should Sprint's position be adopted?

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

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

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

Q. What is GTE's position?

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

Q. Why should Sprint's position be adopted?

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

Q. Does this conclude your testimony?

A. Yes it does.

Corporate Exp Percentage of Total Op Expenses
ARMIS Report 4302 (USOA) - Tier 1 Companies
April 1996

	1995 Corporate Overhead Expenses	1995 Total Operating Expenses	%
Ameritech	878,030	7,598,375	11.56%
Bell Atlantic	1,208,897	8,790,583	13.75%
Bell South	1,525,850	10,171,221	15.00%
NYNEX	1,832,481	9,657,611	18.97%
Pacific	1,352,899	6,895,400	19.62%
Southwestern	817,736	6,350,532	12.88%
US West	1,105,602	7,367,372	15.01%
Total RBOCs	8,721,495	56,831,094	15.35%
GTE / Contel	1,651,765	8,980,302	18.39%
Sprint Local	442,999	3,078,967	14.39%
Cincinnati Bell	168,442	507,003	33.22%
Rochester	28,701	203,219	14.12%
SNET	256,833	1,212,935	21.17%
GRAND TOTAL	11,270,235	70,813,520	15.92%

General Support Plant Percentage of Total Plant
ARMIS Report 4302 (USOA) - Tier 1 Companies
July 1996

	1995 TPIS - General Support	1995 Telephone Plant In Service	%
Ameritech	4,183,214	27,747,309	15.08%
Bell Atlantic	5,203,866	32,016,519	16.25%
Bell South	6,041,583	42,933,973	14.07%
NYNEX	4,239,271	32,131,247	13.19%
Pacific	4,836,198	25,455,945	19.00%
Southwestern	4,246,849	27,683,349	15.34%
US West	5,334,847	30,002,086	17.78%
Total RBOCs	34,085,828	217,970,428	15.64%
GTE / Contel	5,067,562	38,072,347	13.31%
Sprint Local	1,209,569	11,020,915	10.98%
Cincinnati Bell	246,453	1,500,228	16.43%
Rochester	85,564	850,838	10.06%
SNET	798,167	4,043,974	19.74%
GRAND TOTAL	41,493,143	273,458,730	15.17%

EXHIBIT 1

EXHIBIT 2

ACTUAL COSTS DEPLOYED TO MAINTAIN AND SUPPPORT
LOCAL EXCHANGE NETWORK ARE REASONABLE
SWBT - Missouri
1995

	SWBT	SWBT COST %
1		
Direct Facility Invest.		
2 COE	1,099,034,095	
3 C&WF	1,673,530,880	
4 IOT	75,039,189	
5 Operator Systems	10,938,185	
6 *TOTAL DIRECT FACILTY INVESTMENT*	2,858,542,349	
7 COE Reserves	414,319,730	
8 C&WF Reserves	891,113,305	
9 IOT Reserves	41,755,355	
10 Oper Sys Reserves	3,818,130	
11 COE Deferred Taxes	179,633,813	
12 C&WF Deferred Taxes	126,187,649	
13 IOT Deferred Taxes	9,256,719	
14 Oper Sys Deferred Taxes	1,709,367	
15 *TOTAL DIRECT FACILTY RESERVES*	1,467,781,878	
16 Net Investment	1,340,750,343	
17 Direct Return and Tax	218,846,859	20.59%
Direct Facility Exp.		
18 COE Maint.	61,501,660	
19 C&WF Maint.	100,644,722	
20 IOT Maint.	24,167,753	
21 OS Maint.	840,562	
22 COE Depreciation	98,800,455	
23 C&WF Depreciation	81,031,311	
24 IOT Depreciation	6,770,891	
25 OS Depreciation	776,887	
26 Network Operations	81,414,395	
27 Property Tax	65,809,139	
28 Total Direct Expense	498,457,605	46.95%
29 Total Direct Cost	717,304,464	67.55%
Customer Service Related Expenses		
30 Customer Service Exp. (1)	56,728,954	
31 Operator Services (1)	24,698,115	
32 Total Customer Services Expenses	81,427,069	7.66%
Network and Service Support Investments		
33 Gen. Sup. Fac. Inv.	857,523,813	
34 Oth. Investment	56,278,361	
35 Gen. Sup.-Def. Taxes	100,090,799	
36 GSF Reserves	255,224,136	
37 Other Reserves	5,939,785	
38 Net Investment	557,538,555	
39 Support Investment Return and Tax	90,106,844	8.49%
Network and Service Support Expenses		
40 Depreciation (GSF)	50,842,095	
41 Amortization	4,785,315	
42 GSF Expenses	(17,567,984)	
43 Other	3,091,945	
44 Other Taxes	11,816,425	
45 Total Support Expenses	52,967,796	4.99%
Common Costs		
46 Marketing	73,279,585	
47 Corporate	94,745,819	
48 Total Common Costs	168,025,404	11.12%
49 Total Costs	1,061,831,577	100.00%