

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

-----  
In the Matter of :  
Petitions by AT&T Communications :  
of the Southern States, Inc., :  
MCI Telecommunications :  
Corporation and MCI Metro Access :  
Transmission Services, Inc., :  
for arbitration of certain terms :  
and conditions of a proposed :  
agreement with GTE Florida :  
Incorporated concerning :  
interconnection and resale under :  
the Telecommunications Act of :  
1966. :  
-----

DOCKET NO. 960847-TP  
DOCKET NO. 960890-TP



FIRST DAY - MORNING SESSION

VOLUME 1

Pages 1 through 148

PROCEEDINGS: HEARING  
BEFORE: CHAIRMAN SUSAN F. CLARK  
COMMISSIONER J. TERRY DEASON  
COMMISSIONER JULIA L. JOHNSON  
COMMISSIONER DIANE K. KIESLING  
COMMISSIONER JOE GARCIA  
DATE: Monday, October 14, 1996  
TIME: Commenced at 9:30 a.m.  
PLACE: Betty Easley Conference Center  
Room 148  
4075 Esplanade Way  
Tallahassee, Florida  
REPORTED BY: JOY KELLY, CSR, RPR  
Chief, Bureau of Reporting  
ROWENA NASH HACKNEY  
Official Commission Reporter

DOCUMENT NUMBER-DATE

10987 OCT 14 86

FPSC-RECORDS/REPORTING

1 **APPEARANCES:**

2 **TRACY HATCH, ROBIN DUNSON and MICHAEL W.**  
3 **TYE, AT&T Communications of the Southern States,**  
4 **Inc., 101 East College Avenue, Suite 700, Tallahassee,**  
5 **Florida 32301-1509, appearing on behalf of AT&T**  
6 **Communications of the Southern States.**

7 **RICHARD D. MELSON, Hopping Green Sams and**  
8 **Smith, Post Office Box 6526, Tallahassee, Florida**  
9 **32314, and MARTHA McMILLIN, 780 Johnson Ferry Road,**  
10 **Suite 700, Atlanta, Georgia 30342, appearing on behalf**  
11 **of MCI Telecommunications Corporation and MCI Metro**  
12 **Access Transmission Services, Inc.**

13 **ANTHONY GILLMAN, KIM CASWELL, GTE Florida**  
14 **Incorporated, Post Office Box 110, MC 7, Tampa,**  
15 **Florida 32301, EDWARD J. FUHR and KATHLEEN B. MURPHY,**  
16 **Hunton & Williams, Riverfront Plaza, East Tower, 951**  
17 **East Byrd Street, Richmond, Virginia 23219-4074,**  
18 **appearing on behalf of GTE Florida Incorporated.**

19 **DONNA CANZANO, MONICA M. BARONE and CHARLIE**  
20 **J. PELLEGRINI, Florida Public Service Commission,**  
21 **Division of Legal Services, 2540 Shumard Oak**  
22 **Boulevard, Tallahassee, Florida 32399-0850, appearing**  
23 **on behalf of the Commission Staff.**

24

25

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

WITNESSES - VOLUME 1

NAME	PAGE NO.
JOSEPH P. CRESSE	
Direct Examination By Ms. Dunson	28
Prefiled Direct Testimony Inserted	30
JOSEPH GILLAN	
Direct Examination By Ms. Dunson	38
Prefiled Direct Testimony Inserted	41
Cross Examination By Mr. Fuhr	99

EXHIBITS - VOLUME 1

NUMBER		ID.	ADMTD.
1	Order for official recognition	27	27
2	(Cresse) JPC-1	29	38
3	(Gillan) JPG-1	40	

## P R O C E E D I N G S

(Hearing convened at 9:40 a.m.)

**CHAIRMAN CLARK:** We'll call the hearing to order. Please read the notice.

**MS. CANZANO:** Pursuant to notice issued September 12th, a hearing has been set for this time and this place in Dockets 960847 and 960980.

**CHAIRMAN CLARK:** We'll take appearances starting with you, Mr. Gillman.

**MR. GILLMAN:** Yes. Thank you, Chairman Clark. On behalf of GTE Florida Incorporated, my name is Tony Gillman from Tampa, Florida. Also appearing with me today for GTE is Kim Caswell, whom you are well aware of who works in our Tampa office.

And, Chairman Clark, we also -- helping us try this case are two attorneys from Hunton & Williams firm in Virginia, Ed Fuhr, next to me on my left, is a partner in the Hunton & Williams firm and is a member in good standing of the Virginia bar and is admitted to practice before all courts within that state. He is also admitted to practice in the Third, Fourth, Sixth Circuits, as well as the United States Supreme Court.

To his left is an associate in that firm Katie Murphy, who is admitted to practice in all

1 courts in Virginia and Wisconsin.

2 At this time pursuant to the Commission  
3 rules, I would move that Mr. Fuhr and Ms. Murphy be  
4 permitted to appear before the Commission in this  
5 case.

6 CHAIRMAN CLARK: We'll accept their  
7 appearance before the Commission in this case, but  
8 would you spell their last names for me?

9 MR. GILLMAN: Mr. Fuhr is F-U-H-R, and  
10 Ms. Murphy is M-U-R-P-H-Y.

11 CHAIRMAN CLARK: Okay. Thank you very much.

12 MR. GILLMAN: Thank you, Chairman Clark.  
13 Ms. Dunson.

14 MR. HATCH: I'm not Ms. Dunson. (Laughter)

15 Tracy Hatch, Robin Dunson and Michael W.  
16 Tye, appearing on behalf of AT&T. Also appearing with  
17 us in this hearing will be Sandy Hoe, Tom Lemmer and  
18 Tami Azorsky from the law firm of McKenna & Cuneo.

19 Our AT&T address is 101 North Monroe Street,  
20 Tallahassee, Florida. The address for the McKenna &  
21 Cuneo firm is 1900 K Street, N.W., Washington, D.C.

22 MR. MELSON: Richard Melson of the law firm  
23 Hopping Greens Sams and Smith, P.A., Tallahassee,  
24 Florida, appearing on behalf of MCI.

25 Also appearing with me is Martha McMillin of

1 MCI in Atlanta.

2 MS. CANZANO: I'm Donna Canzano. Appearing  
3 with me is Charlie Pellegrini, and also appearing will  
4 be Monica Barone. And we are appearing on behalf of  
5 the Commission Staff.

6 CHAIRMAN CLARK: Okay. Ms. Canzano, what  
7 preliminary matters do we need to take up?

8 MS. CANZANO: The primary preliminary matter  
9 would be GTE's Motion to Deny AT&T's request regarding  
10 implementation of the FCC's default proxy rates.

11 CHAIRMAN CLARK: Anything else?

12 MS. CANZANO: Just that Staff requests  
13 official recognition.

14 CHAIRMAN CLARK: Okay. Mr. Gillman, is  
15 there anything besides the Motion that we have to take  
16 up prior to beginning the hearing?

17 MR. GILLMAN: No, Chairman Clark.

18 CHAIRMAN CLARK: Mr. Hatch.

19 MR. HATCH: There a number of items that  
20 AT&T must bring to your attention. First, as of the  
21 prehearing conference, we did not know that there  
22 would be some conflicts for Dr. Kaserman's appearance  
23 at this hearing. He is in Wisconsin today, and I  
24 believe in Iowa tomorrow. We would request that he be  
25 allowed to appear first thing Wednesday morning, or on

1 Wednesday, however the order works out. We would note  
2 that a couple of other witnesses have been taken out  
3 of order for various and similar conflictry.

4 CHAIRMAN CLARK: I have no objection to that  
5 so long as we are still in hearing at that point.  
6 That isn't a license to draw out your questions  
7 either. (Laughter)

8 MR. GILLMAN: Chairman Clark?

9 CHAIRMAN CLARK: Yes.

10 MR. GILLMAN: We have no objection to that.  
11 Our only request would be that our economic witness  
12 follows at some point Mr. Kaserman.

13 CHAIRMAN CLARK: Okay.

14 MR. HATCH: And we have no objection to  
15 that.

16 CHAIRMAN CLARK: All right.

17 MR. HATCH: We would also request that,  
18 likewise, as you saw last week in the BellSouth  
19 hearing, with respect to our technical witness,  
20 Mr. Ray Crafton, we would request that the Chair give  
21 us an extension on the summary limit for 15 minutes to  
22 do a CD Rom presentation similar to what was done last  
23 week. It isn't the same presentation, we're just  
24 doing a little bit different piece of it this time.

25 CHAIRMAN CLARK: Any objection to that?

1           **MR. GILLMAN:** No objections. We would have  
2 a similar request with respect to our witness who is  
3 going to show a tape.

4           **CHAIRMAN CLARK:** And who is that?

5           **MR. GILLMAN:** That's Mr. Hartshorn.

6           **CHAIRMAN CLARK:** Okay.

7           **MR. HATCH:** And then with respect to  
8 Issue 3, the discount listed in AT&T's position under  
9 Issue 3, currently it's 30.99%. That should be  
10 changed and revised to say 36.9%.

11           **CHAIRMAN CLARK:** Anything else, Mr. Hatch?

12           **MR. HATCH:** One last matter. With respect  
13 to -- as you recall last week, we used a number of  
14 charts during the course of the witnesses' summaries,  
15 and similar to that we are using some similar charts  
16 with respect to our witnesses in this proceeding. And  
17 for your convenience, we would like to go ahead and  
18 pass out the printed copies so that it's easier for  
19 you to see. And since they are over there, and you  
20 are over there, and it's hard for you to see in a room  
21 this big.

22           **CHAIRMAN CLARK:** The printed charts, you are  
23 going to give us in that file again?

24           **MR. HATCH:** Yes, that's correct.

25           **CHAIRMAN CLARK:** Thank you, very much.



1           **MR. HATCH:** It's the same thing that you had  
2 last week.

3           **CHAIRMAN CLARK:** Mr. Gillman, any objection?

4           **MR. GILLMAN:** Well, I would reserve  
5 objections at the time they come in, I think.

6           **CHAIRMAN CLARK:** All right. You have no  
7 objection to them passing out the copies to us, but  
8 otherwise have an objection as it being an exhibit; is  
9 that correct?

10          **MR. GILLMAN:** Yes, that's correct.

11          **CHAIRMAN CLARK:** Okay. Mr. Hatch.

12          **MR. HATCH:** I think that's all we've got,  
13 thank you.

14          **CHAIRMAN CLARK:** Okay. Mr. Melson.

15          **MR. MELSON:** No preliminary matters.

16          **CHAIRMAN CLARK:** All right. Then we are on  
17 the Motion to Deny AT&T's request regarding  
18 implementation of the FCC's default proxy rate.

19          **MR. GILLMAN:** Yes, Chairman Clark, we are  
20 prepared to argue that; and Mr. Fuhr is going to make  
21 GTE's argument.

22          **CHAIRMAN CLARK:** All right. Let me get that  
23 in front of me.

24                 I apologize. I did not take those home with  
25 me over the weekend, so I have not read them. Tell me

1 what I should have in front of me, Ms. Canzano.

2 MS. CANZANO: You should have GTE's Motion,  
3 and you should have a response by AT&T and a response  
4 by MCI. We can take a set up to you. (Tendering.)

5 CHAIRMAN CLARK: Was there a Motion for Oral  
6 Argument on this?

7 MR. GILLMAN: We did not file a formal  
8 written Motion for Oral Argument, but at the  
9 prehearing conference the question was raised whether  
10 oral comments would be taken at the prehearing  
11 conference or at the hearing. And it was decided at  
12 that time the oral comments would be taken the first  
13 thing at that point the hearing commenced.

14 CHAIRMAN CLARK: Then, it's GTE's Motion; is  
15 that correct?

16 MR. GILLMAN: That is correct.

17 CHAIRMAN CLARK: We'll hear from GTE.

18 MR. FUHR: Thank you. Chairman Clark,  
19 members of the Commission, my name again is Ed Fuhr  
20 with the law firm of Hunton & Williams in Richmond,  
21 Virginia. And I'm here to speak at this point on  
22 GTE's Motion to Dismiss the request of AT&T and MCI to  
23 establish the FCC's default proxy rates and to strike  
24 all testimony related thereto.

25 Imposition of the FCC's default proxy rates

1 would impose enormous irreparable and unconstitutional  
2 losses on GTE. For those reasons, we believe this  
3 Commission should not even consider such evidence in  
4 these proceedings. As grounds for on this Motion, we  
5 have three grounds. One is that there is insufficient  
6 evidence, and there is no evidence, indeed in the  
7 record in this case, that will support the  
8 reasonableness of these rates.

9           Second, the FCC Order on which the default  
10 proxy rates are based is a fatally flawed, unlawful,  
11 convoluted power grab by the federal government. And  
12 I'll talk about that in a little more detail.

13           And three, the imposition of default proxy  
14 rates would be a taking in violation of the Fifth  
15 Amendment to the U.S. Constitution. It would be a  
16 taking of the private property of GTE.

17           We have an unusual animal in the  
18 deregulation of the telecommunications industry. We  
19 have a federal legislation that purports to do that  
20 deregulation. The FCC attempted to promulgate some  
21 regulations, some 700 pages worth of regulations, to  
22 further that end. Commissions like this have been set  
23 up all across the country in the states to implement  
24 that deregulation. And then the final twist is that  
25 it's all going to be reviewed by a federal court with

1 respect to all the matters and decisions that are made  
2 in these state commissions. So it's a very unusual  
3 procedural device that has been set up to accomplish  
4 this end.

5           The FCC in it's Order suggested that the  
6 states could implement default proxy rates in the  
7 event that they could not consider cost studies. We  
8 believe that this Commission can and has the time and  
9 ability to consider the cost studies and, indeed,  
10 those studies have been prefiled here, and all the  
11 parties have evidence that they will be presenting on  
12 those.

13           The FCC Order is an Order that I know this  
14 Commission knows well as it was a subject of a brief  
15 that was filed by this Commission seeking a stay of  
16 that FCC Order. GTE also filed a stay of that Order.  
17 It was first filed with the FCC. The FCC denied the  
18 request for the stay, but it's interesting to note in  
19 that September 17th Order that denied the stay, the  
20 FCC specifically noted that GTE's concerns that its  
21 costs were substantially in excess of the proxy rates  
22 were ones that should be presented to these state  
23 commissions. The FCC would not be the one imposing  
24 that taking. And so, in effect, you are seeing an  
25 effort to shift the legal responsibility to these

1 state commissions if they impose the proxy rates.

2 As this Commission knows, the federal  
3 government and the FCC cannot expand or limit this  
4 Commission's authorities and responsibilities. The  
5 primary responsibility being one to set rates that are  
6 reasonable and that are born out by the facts in the  
7 record that it developed before this Commission.

8 There will not be any evidence in this  
9 record as to the reasonableness of the FCC's rates.  
10 The only basis for those rates is the shear dicta in  
11 the FCC Order. That is an Order, however, that has  
12 been stayed by the Eighth Circuit U.S. Court of  
13 Appeals. That Order has no legal effect whatsoever.  
14 And whether that will change down the road, who's to  
15 know. And when that will occur, no one is to know.

16 I think there's some expectation that is a  
17 further decision from the Eighth Circuit, will occur  
18 in the next couple of weeks. But the preliminary stay  
19 is in effect and remains in effect until there is  
20 further ruling. The ultimate ruling on the merits --  
21 the actual argument on the merits, I believe, is to  
22 occur in January of this year. So the stay could be  
23 in effect at least until that long.

24 And the reason for seeking the stay that GTE  
25 sought and other organizations sought was that the

1 proxy rates, in particular, there was no basis to  
2 them. There was no explanation as to where they were  
3 derived. The logic behind them was internally  
4 inconsistent. In particular, they sought to rely on  
5 some information from Florida, some studies from  
6 Florida. They got those all wrong and turned those  
7 around, and many of that is laid out in the very brief  
8 that this Commission filed. And there is no point of  
9 me repeating that.

10 Finally, I would state that the imposition  
11 of these proxy rates would be a taking. And may well  
12 be a taking by the State of Florida and by this  
13 Commission of GTE's private property because these  
14 proxy rates are dramatically below GTE's costs.

15 As this Commission stated in its brief, "For  
16 Florida, the proxy rate is arbitrarily low and sends  
17 the wrong economic signals to the marketplace."  
18 That's precisely our viewpoint. And in light of that  
19 and in light of the fact that there is no evidence in  
20 the record to support their reasonableness whatsoever,  
21 we submit that we ought not hear any evidence in this  
22 proceeding that relates to proxy rates, that is based  
23 on those proxy rates. We've got a lengthy list of  
24 witnesses, close to 30 witnesses, we are going to be  
25 hearing from in the next three days. So we've got a

1 lot in front of us. And one way to trim the sails a  
2 little bit might be to throw out and throw overboard  
3 some of those proxy rates that just have no basis in  
4 reality. So we would ask that this Commission strike  
5 AT&T and MCI's petition for the imposition of the  
6 default proxy rates. And indeed I note in MCI's  
7 response to our Motion, they have clarified that they  
8 are not seeking the default proxy rates. Thank you.

9 CHAIRMAN CLARK: Mr. Hatch.

10 MR. MELSON: I'm going to go first on behalf  
11 of MCI.

12 CHAIRMAN CLARK: Okay.

13 MR. MELSON: Commissioners, that's correct,  
14 MCI is not seeking imposition of the default proxy  
15 rates. We're asking you to make a decision based on  
16 the evidence you will see in this proceeding. We  
17 recognize, however, that if the FCC's Order is  
18 unstayed and if you determine that there is not  
19 sufficient evidence in this proceeding for you to feel  
20 comfortable adopting a permanent rate, the FCC default  
21 proxies do give you an opportunity to do something on  
22 an interim basis.

23 With respect to the notion that those proxy  
24 rates are totally unsupported, we believe you will  
25 hear evidence from our witnesses -- of AT&T's

1 witnesses with regard to the Hatfield study, with  
2 regard to an avoided cost study. And while our  
3 position is obviously different than GTE's, we believe  
4 you will hear that rates lower than the default  
5 proxies are fully appropriate. In essence GTE, we  
6 believe, is asking you on a Motion to Dismiss the use  
7 of default proxy rates to prejudge the evidence that  
8 you have not yet heard as to what appropriate rates  
9 are for GTE under the guidelines in the federal  
10 statute.

11           With respect to the taking argument, again  
12 that is a variation on the theme. There is no taking  
13 so long as you set rates that meet the applicable  
14 judicial and statutory standards. We believe you will  
15 hear testimony in this case that lets you set such  
16 rates. And as I say, in fact, we believe in some  
17 cases those are below the FCC's default proxies. The  
18 proxies come into place only if you find that the  
19 evidence, both for GTE and from the petitioners here,  
20 is ultimately insufficient for you to make a final  
21 conclusion.

22           We, frankly, think it's much ado about  
23 nothing and would urge you to deny the Motion to  
24 Dismiss.

25           **CHAIRMAN CLARK:** Mr. Hatch.



1           **MR. HATCH:** I would echo the comments of  
2 Mr. Melson. I would also point out that GTE's Motion,  
3 it also seeks to preclude, in terms of its Motion to  
4 strike all the testimony from establishing what are  
5 the proxy rates as a permanent rate, notwithstanding  
6 any evidence that may be presented in this case to  
7 support it.

8           AT&T endorses the proxies, but only to the  
9 extent that you cannot set permanent rates or are not  
10 comfortable setting permanent rates based on the  
11 evidence in this proceeding. And we're advocating  
12 Hatfield is the methodology to do that.

13           One final matter that I bring to your  
14 attention is that this Motion apparently, either a  
15 substantially similar and identical motion was filed  
16 in Hawaii, and the Hawaiian commission has denied that  
17 motion pursuant to order 15040 in their  
18 Docket 96-0329. And that order was issued 9/30/96.

19           Essentially, let me read to you the  
20 conclusion of the Hawaiian order. GTE Hawaiian Tel's  
21 motion essentially asks that the Commission render a  
22 decision at this time to abstain or forego from the  
23 use of the proxy default approach. We decline to do  
24 so. It would be premature and imprudent for the  
25 commission to foreclose, at the outset of the

1 arbitration proceeding, any available option in  
2 determining the pricing issue between the parties.  
3 Thus notwithstanding the jurisdictional constitutional  
4 challenges raised by GTE Hawaiian Tel, we will deny  
5 AT&T (sic) Hawaiian Tel's motion.

6           Essentially, that is the argument. They are  
7 asking you to essentially wipeout all the evidence  
8 that would in fact support what we are advocating in  
9 this proceeding. And then having done so, say, "Well,  
10 our rates are the only ones left."

11           One final matter. GTE does not contend that  
12 you cannot set an interim rate. In fact, it says if  
13 you choose to do so, please adopt our proposed interim  
14 rates -- our proposed rate as an interim rate. So  
15 there is no contest here about whether interim is  
16 available, they just would preclude consideration of  
17 anyone's interim but their own.

18           **CHAIRMAN CLARK:** Mr. Fuhr.

19           **MR. FUHR:** Just briefly. We do not have  
20 legal opposition to the imposition of an interim rate  
21 provided that it is a rate that is based on the record  
22 evidence that is developed in this proceeding. The  
23 problem with the FCC proxy rates is that there is no  
24 one coming in to present evidence as to the  
25 reasonableness of those rates. The FCC certainly, in

1 their 700 pages, could not find any room to explain  
2 those rates.

3           With respect to what some of the different  
4 states are doing, I suspect that in a few weeks we  
5 will have probably 28 different states coming out at  
6 different places along the pendulum. But I would note  
7 is that Florida, unlike Hawaii, has looked into a lot  
8 of these issues and has studied these issues in some  
9 detail. And again, going back to the very brief that  
10 was prepared by this Commission, this Commission noted  
11 that specific proxy rates were unreasonably low. And  
12 they noted that this Commission had found -- I forgot  
13 what it was -- a \$20 rate for loops, whereas the FCC  
14 had come out with \$13, not quite 50% below that. And  
15 that's just a huge swing.

16           And yet, the FCC purportedly was relying on  
17 the very data that this Commission had before it. And  
18 it was for all those reasons that many parties said  
19 that the FCC's declarations were arbitrary. They were  
20 capricious. They were pulled out of thin air.

21           And the very serious harm that they would  
22 impose is that a company, such as GTE, would be  
23 required to furnish services to AT&T below cost.  
24 Well, that is an untenable position. In  
25 constitutional terms it is a taking; it is a violation

1 of law. And as this tug and forth -- going back and  
2 forth between the states. And the federal government  
3 as to who is going to have responsibility if that ever  
4 gets done in the different states, the FCC's trying to  
5 say, "Well, the states, let them deal with that issue  
6 as to wether costs" --

7 So those would be responses to the specific  
8 points raised, I think, by AT&T and MCI. If there are  
9 any specific questions that I can answer, I'd be happy  
10 to do that.

11 CHAIRMAN CLARK: Thank you. Questions,  
12 Commissioners?

13 COMMISSIONER DEASON: Yes, I have a  
14 question. Isn't it the purpose of this proceeding to  
15 determine what the relevant costs are and what the  
16 costs entered should be? And absent an opportunity of  
17 parties to present that evidence, this Commission  
18 would not have the information to base that decision  
19 upon?

20 MR. FUHR: The purpose of this hearing is to  
21 hear evidence with respect to proposals of these  
22 parties and of the cost studies that underlie them.  
23 The problem with the FCC proxy rates is there's no one  
24 supporting the reasonableness of those. AT&T has  
25 their Hatfield Model, and there are various problems

1 with that. And we'll get into that at the appropriate  
2 time. And we are not trying to strike the Hatfield  
3 Model at this time, although that is a motion that we  
4 ultimately will make.

5 But my point simply is that we ought not  
6 have witnesses coming up here saying, "Well, we  
7 propose the FCC's proxy rates and believe them  
8 reasonable." Why? Because it's in the FCC Order.  
9 Well, that Order is an order that's of no legal  
10 effect, it's been stayed. And it saves a lot of cross  
11 examination time if I don't have to go into the  
12 witnesses' discussions of proxy rates, and we can  
13 simply focus on the Hatfield Model that AT&T wishes to  
14 put forward. I've got no problem cross examining them  
15 on that. I just think we ought to save time and not  
16 have our people have to challenge and attack the FCC  
17 proxy rate, have to cross examine their witnesses on  
18 those issues as well.

19 COMMISSIONER DEASON: If they don't have any  
20 substantial evidence supporting the basis for the  
21 proxy, what's to cross examine?

22 MR. FUHR: Well, in fact, there's nothing  
23 that's been prefiled. But they have it as part of  
24 their petition that they want it and that there's no  
25 evidence that's being filed on behalf of that. And if

1 they haven't prefiled the evidence, then we ought to  
2 just strike that part of the petition.

3 COMMISSIONER KIESLING: Madam Chairman?

4 CHAIRMAN CLARK: Yes.

5 COMMISSIONER KIESLING: While the  
6 possibilities of shortening cross examination is  
7 certainly an attractive one after having done this  
8 last week, I think we would be ill advised to grant  
9 the Motion at this time because it seems to me that  
10 the whole purpose for us to be here is to fully  
11 explore all of these issues. And I'm not willing to  
12 preclude the possibility of presenting evidence that  
13 may support one of these possibilities.

14 So for that reason, I would move that we  
15 deny the Motion.

16 COMMISSIONER DEASON: And for those reasons,  
17 I would second that motion.

18 CHAIRMAN CLARK: All those in favor say aye.

19 COMMISSIONER DEASON: Aye.

20 COMMISSIONER KIESLING: Aye.

21 COMMISSIONER JOHNSON: Aye.

22 COMMISSIONER GARCIA: Aye.

23 CHAIRMAN CLARK: Aye. Opposed nay.

24 COMMISSIONER JOHNSON: I do have a question  
25 though, but it's not going to affect my vote.

1                   **CHAIRMAN CLARK:** Okay.

2                   **COMMISSIONER JOHNSON:** And it's for GTE.  
3 With respect to a proxy rate, what if we were to  
4 determine, even based upon the evidence that's  
5 presented here on Hatfield -- and I don't think anyone  
6 is doing the benchmark cost model -- but with respect  
7 to the methodologies, what if Staff doesn't feel  
8 comfortable with the evidence that is presented and  
9 doesn't feel that any of the information leads to  
10 anything that we would want to establish on a  
11 permanent basis. Could we then, from the evidence  
12 that's presented, come up with our own interim proxy  
13 rates?

14                   **MR. FUHR:** I believe any rates that this  
15 Commission implements needs to be rates that are based  
16 on a record. And that is the fundamental challenge  
17 before this Commission.

18                   So, say you are torn between the evidence or  
19 you think there are problems with the models GTE has  
20 put forward and those put forward by AT&T, I don't  
21 think that would give you license as a matter of law  
22 to go to the FCC's proxy rates. So whatever --

23                   **COMMISSIONER JOHNSON:** But we could  
24 establish our own, but still make them interim?

25                   **MR. FUHR:** As long as there is a basis in

1 the record and as long as they cover GTE's actual  
2 costs. Because, again, the other fundamental  
3 challenges, if GTE's costs for providing these  
4 services are not paid for, then as a matter of  
5 constitutional law, our property is being taken. I'm  
6 being asked to give away something for less than what  
7 it costs me to make it. And the Constitution of the  
8 United States says that nobody, no government, may  
9 require a private party to do that. And if rates are  
10 set below our costs, you have violated our  
11 constitutional rights. And that will set off a legal  
12 challenge to those rates because that's an untenable  
13 position. No party can give away something for free  
14 or close to it.

15           So that's why we are going to be so strong,  
16 I think, in saying, "Look, the FCC proxy rates are a  
17 nonstarter and a lot of problems with the Hatfield  
18 Model are going to occur in that same rink." But in  
19 the end, there needs to be a basis in this record for  
20 whatever conclusion this Commission comes to with  
21 respect to rates. And those rates have to be at least  
22 sufficient to cover our costs.

23           COMMISSIONER JOHNSON: And with respect to  
24 the proxies that the FCC came up -- or developed,  
25 there is this presumption, for at least with respect



1 to how, I guess, their order is crafted, there is a  
2 presumption of validity with respect to those rates.  
3 And I guess what you are saying is, to the extent that  
4 there's nothing in this record that validates those  
5 particular rates, that then those rates should not be  
6 the ones that we adopt under any circumstances.

7           **MR. FUHR:** Yes. But the presumption of  
8 validity does not attach here because that FCC Order  
9 has been stayed. And the reason it was stayed is  
10 because a lot of parties filed challenges and said  
11 what they did was unlawful; it was illegal. And so,  
12 there's no presumption of validity there. If  
13 anything, the presumption ought to be that it's  
14 invalid and unlawful because a Federal Circuit Court  
15 of Appeals has so ruled, and that's the binding law of  
16 the land that governs all of us here.

17           **COMMISSIONER JOHNSON:** And what happens if  
18 the stay is lifted and if the FCC Order is affirmed --  
19 or whatever you call it.

20           **MR. FUHR:** Right.

21           **COMMISSIONER JOHNSON:** What then happens  
22 with those proxy rates?

23           **MR. FUHR:** If the stay is lifted, this  
24 Commission will still retain those two primary  
25 challenges that I talked about. You still have to set

1 a rate that has basis in the record before you, a).  
2 And b) it has got to be sufficient to cover our costs.  
3 Any rate that is set that is below our costs, no  
4 matter where it's gotten from, whether it's from  
5 evidence that you heard, whether it's from the FCC, if  
6 it's below our costs, that's unlawful; that's illegal.  
7 That's a taking of our property, and that puts us in a  
8 position of having to say, do we sue the FCC, do we  
9 sue the State of Florida, this commission? I mean, it  
10 gets into all of those issues. So the lifting of the  
11 stay, if that were to occur -- and we don't think it  
12 will -- but if that were to occur is not going to be a  
13 panacea.

14 That doesn't really help this Commission out  
15 or help anyone that's proposing the proxy rates out  
16 very much because you are still going to have that  
17 tremendous burden of showing that they are reasonable.  
18 And that's a burden that I don't think is going to be  
19 one that anyone can sustain.

20 COMMISSIONER JOHNSON: Okay, thank you.

21 CHAIRMAN CLARK: The Motion has been denied.  
22 Is there anything further we have to take up at this  
23 time?

24 MS. CANZANO: At this time Staff requests  
25 orders for official recognition, and we have

1 distributed them in our exhibit package.

2           **CHAIRMAN CLARK:** All right. We will mark as  
3 Exhibit 1 the document entitled Orders for Official  
4 Recognition in these dockets, and it will be admitted  
5 in the record without objection. And we will take  
6 official notice of all the orders listed on that  
7 document.

8           **MS. CANZANO:** Thank you.

9           (Exhibit 1 marked for identification and  
10 received in evidence.)

11           **CHAIRMAN CLARK:** That concludes preliminary  
12 matters, so we are ready to begin taking testimony; is  
13 that correct? All right.

14           I'd like to ask that everyone who is going  
15 to be a witness in this proceeding that is here now,  
16 please stand and raise your right hand. And I will  
17 swear in all of you at the same time.

18           (Witnesses collectively sworn.)

19           **CHAIRMAN CLARK:** Thank you.

20           **MS. DUNSON:** Madam Chairman, AT&T would like  
21 to call our first witness, Mr. Joe Cresse.

22           **CHAIRMAN CLARK:** Mr. Cresse.

23

- - - - -

24

25

1                                   **JOSEPH P. CRESSE**

2 was called as a witness on behalf of AT&T  
3 Communications of the Southern States and, having been  
4 duly sworn, testified as follows:

5                                   **DIRECT EXAMINATION**

6 **BY MS. DUNSON:**

7           **Q**     Good morning, Mr. Cresse. Would you please  
8 state your name your name and business address for the  
9 record?

10           **A**     Yes. My name is Joseph P. Cresse. Business  
11 address is P.O. Box 1876, Tallahassee, Florida 32302.

12           **Q**     By whom are you employed and in what  
13 capacity?

14           **A**     I'm employed as a special consultant in the  
15 law firm of Messer, Caparello, Madsen, Goldman & Metz.

16           **Q**     Did you cause to be prepared six pages of  
17 direct testimony which was prefiled on behalf of AT&T  
18 in this proceeding on August 16, 1996?

19           **A**     Yes, I did.

20           **Q**     Do you have any changes or correction to  
21 your testimony?

22           **A**     No, I do not.

23           **Q**     If I asked you the same questions today as  
24 are contained in your prefiled direct testimony, would  
25 your answers be the same?

1           **A**     Yes, they would.

2                   **MR. DUNBAR:** Madam Chairman, I request that  
3 Mr. Cresse's direct testimony be inserted into the  
4 record as though read.

5                   **CHAIRMAN CLARK:** Mr. Cresse's direct  
6 testimony will be inserted in the record as though  
7 read.

8           **Q**       **(By Ms. Dunson)** Mr. Cresse, did you also  
9 prepare one exhibit which was attached to your direct  
10 testimony?

11           **A**     Yes.

12           **Q**       Do you have any changes or corrections to  
13 make to this exhibit?

14           **A**     No.

15           **Q**       **(By Ms. Dunson)** Madam Chairman, I request  
16 that Mr. Cresse's Exhibit JPC-1 be marked for  
17 identification.

18                   **CHAIRMAN CLARK:** It will be marked as  
19 Exhibit 2.

20                           (Exhibit 2 marked for identification.)

21

22

23

24

25

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

**DIRECT TESTIMONY OF**

**JOSEPH P. CRESSE**

**ON BEHALF OF AT&T COMMUNICATIONS**

**OF THE SOUTHERN STATES, INC.**

**Docket No. 960847 - TP**

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

A. My name is Joseph P. Cresse. My business address is Post Office Box 1876,  
Tallahassee, Florida 32302. I am presently employed as a non-lawyer special  
consultant at Messer, Caparello, Madsen, Goldman & Metz, P.A. law firm.

**Q. PLEASE STATE YOUR BACKGROUND AND QUALIFICATIONS.**

A. Please see Exhibit JPC-1 attached to my testimony.

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

A. To suggest a basic policy approach this Commission should adopt in reviewing and  
determining the issues in this arbitration.

**Q. WHY IS THAT SIGNIFICANT?**

A. It is extremely significant because state commissions throughout this country must

1 take the initiative to achieve the objectives of the Telecommunications Act of 1996  
2 (the "Act"); to promote competition so that consumers will have choices for all of  
3 their telecommunications needs. The Act envisions a competitive local services  
4 market. As we know from past experience, however, introducing competition in a  
5 monopoly market will not be easy. Without aggressive action by state commissions  
6 to encourage and stimulate competition, this endeavor will not work.

7

8 **Q. WHAT LEADS YOU TO THAT CONCLUSION?**

9

10 A. A review of the history of introducing competition in telecommunications suggests  
11 that existing monopolists, left to their own devices, will make the introduction of  
12 competition as beneficial to themselves as they possibly can. This means that the  
13 incumbent local exchange carriers ("LECs") will interpret the competition  
14 requirements of the Act as narrowly as they can in their efforts to minimize losses of  
15 local service customers. Given the inherent difficulties of breaking up a 100 year  
16 old monopoly, state commissions must be diligent in their efforts to promote local  
17 competition.

18

19 **Q. WHAT IS THE BASIS FOR YOUR OPINION?**

20

21 A. I joined the Florida Public Service Commission in 1979. Just prior to that date,  
22 consumers were permitted for the first time to provide their own phone instrument.  
23 Before this occurred, a customer was required to rent a phone from the local phone  
24 company in order to obtain phone service. After many years of litigation, and over  
25 the protestations of the local phone companies, who claimed the attachment of

1 "foreign" phones to their network would harm their networks, competition was  
2 introduced for customer premises equipment. For a while a useless "protector" was  
3 required if a "foreign" phone was used by a LEC customer. (Many of the same  
4 arguments were made when inside wire was deregulated.) Of course, as we know  
5 now, such "protectors" proved unnecessary and simply served as another costly  
6 impediment to competition.

7  
8 Prior to the introduction of competition in the long distance industry, service was  
9 provided jointly by the LECs and AT&T Long Lines. The LECs provided the  
10 connections to and from individual customers for originating and terminating long  
11 distance calls ("the last mile") and AT&T Long Lines provided the intercity  
12 transmission facilities for such calls. Because new long distance competitors also  
13 needed access to customer lines for originating and terminating long distance calls,  
14 the major issue in establishing competition was the level of access charges other  
15 long distance carriers would be required to pay LECs for such access.

16  
17 At the time, this access or interconnection between AT&T Long Lines and the LECs  
18 was of a higher quality and more convenient (requiring the dialing of fewer digits)  
19 for customers than the interconnection provided to other long distance competitors.  
20 The regulatory response to this disparity was to give a substantial discount for less  
21 than "equal access." The discount was 55% for interstate calls and 35% for intrastate  
22 calls in Florida. To accomplish equal access, it was necessary for regulators to order  
23 it. This regulatory policy provided incentives to the LECs to provide equal access to  
24 all long distance carriers as quickly as economically feasible because the discount  
25 was eliminated when equal access was provided. I believe the Commission should



1 order similar incentives to encourage compliance with the requirements set forth in  
2 the Act to bring about local exchange competition.

3

4 Also, until competition was established, regulators continued to require the  
5 dominant carrier to satisfy more stringent regulatory requirements than those  
6 imposed on new entrants for the filing of tariffs, the approval of rate changes, and  
7 the "pass through" of reductions in access charges. Regulators also required that the  
8 dominant carrier could not prohibit resale of its services. As a result, today we have  
9 both resale competition and facilities based competition in the toll business.

10 Commission policy should embrace these same kinds of requirements to promote  
11 local exchange competition.

12

13 **Q. WHAT RESPONSE TO THE INTRODUCTION OF COMPETITION**  
14 **WOULD REQUIRE CLOSE REGULATORY SCRUTINY?**

15

16 A. Based on past actions and some current proposals, I would expect the incumbent  
17 LECs to propose opening their local networks to competition in a manner that  
18 retains for themselves all the advantages that regulators permit.

19

20 **Q. CAN YOU GIVE SOME EXAMPLES OF EXPECTED INCUMBENT LEC**  
21 **RESPONSES TO ISSUES IN THIS DOCKET?**

22

23 A. Yes.

24

25 1. I would expect incumbent LECs to attempt to minimize the discounts on

1 resale to the maximum extent possible.

2

3 2. I would expect incumbent LECs to minimize the network functions or  
4 elements they believe should be unbundled.

5

6 3. I would expect incumbent LECs to attempt to enter into long term contracts  
7 with existing customers under their Contract Service Arrangements ("CSAs")  
8 authority prior to any actual competition.

9

10 4. I would expect incumbent LECs to offer differential pricing in those areas  
11 where they have or soon expect competition, such as zone density-based access  
12 charges.

13

14 5. I would expect incumbent LECs to attempt to maximize their revenues from  
15 interconnection and other services provided to new entrants.

16

17 6. I would expect incumbent LECs to use universal service as a means to  
18 extract the highest contributions possible from their competitors.

19

20 The Commission needs to recognize each of these tactics for what they are -  
21 attempts to limit competition -- and take steps to ensure that consumers' interests  
22 and not incumbent LECs' interests are protected.

23

24 **Q. ARE THERE OTHER FACTORS THE COMMISSION SHOULD**  
25 **RECOGNIZE?**

1

2 A. Yes, at one time, under rate base regulation, protecting the LECs could be justified  
3 as protecting consumers, because any revenues lost would need to be "made up"  
4 from remaining customers. This is no longer true under the form of regulation  
5 applied to incumbent LECs like GTE. The Commission has no authority to prevent  
6 or approve rate changes. The maximum rates are established by Florida law and  
7 regulated LECs have the authority to set rates up to the maximum permitted.

8

9 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

10

11 A. The absolute best way for this Commission to protect consumers is to promote  
12 competition in Florida to the maximum extent permitted by law through the  
13 adoption of orders and policies that increase choices for consumers.

1           Q           (By Ms. Dunson) Mr. Cresse, did you  
2 prepare a summary of your testimony?

3           A           Yes.

4           Q           Would you please give it for the record?

5           A           Yes. Commissioners, good morning. Last  
6 week when I testified, I told you it was in the  
7 consumers' best interest for you to promote  
8 competition to the best of your ability. I mentioned  
9 some of the historic problems regulators have had in  
10 overcoming and in establishing competition in long  
11 distance customer premise equipment and inside wiring.  
12 I also mentioned some of the actions that you can  
13 expect from the local exchange companies in order for  
14 them to maintain a competitive advantage. So rather  
15 than repeat all of that today, since my testimony is  
16 essentially the same as in last week's case, let me  
17 just say this, that the decisions you make in the  
18 BellSouth docket and in this docket will go a long way  
19 in determining if Florida's consumers will have the  
20 benefit of competition. I suggest you ask yourself on  
21 each issue what decision can I make that will best  
22 promote competition, and then just do it because it's  
23 the right thing to do.

24                       I also would like to mention that GTE does  
25 not have the same incentives to promote competition,

1 even that Southern Bell had. They do not have to pass  
2 the 14-point test that Bell has to pass. They are in  
3 the long distance business; they are in the cable TV  
4 business. Southern Bell at least has to wait until  
5 they can demonstrate that they have competition. That  
6 completes my summary.

7 MS. DUNSON: Thank you, Mr. Cresse. The  
8 witness is available for cross examination.

9 CHAIRMAN CLARK: Mr. Melson.

10 MR. MELSON: No questions.

11 CHAIRMAN CLARK: Mr. Gillman.

12 MR. GILLMAN: No questions, Chairman Clark.

13 MS. CANZANO: No questions.

14 CHAIRMAN CLARK: Commissioners.

15 Thank you, Mr. Cresse.

16 WITNESS CRESSE: Thank you, Commissioner.

17 MS. DUNSON: Madam Chairman, I'd move for  
18 the admission of Exhibit 2 into the record.

19 CHAIRMAN CLARK: The exhibit will be  
20 admitted without objection.

21 Let me just indicate to the parties again,  
22 if you know that there is a witness that you are not  
23 going to cross examine, if you would let the party  
24 know who's sponsoring the witness and we can stipulate  
25 the testimony into the record.

1 (Exhibit 2 received in evidence.)

2 MS. DUNSON: AT&T would like to call our  
3 second witness, Mr. Joe Gillan.

4 - - - - -

5 JOSEPH GILLAN

6 was called as a witness on behalf of AT&T  
7 Communications of the Southern States and, having been  
8 duly sworn, testified as follows:

9 DIRECT EXAMINATION

10 BY MS. DUNSON:

11 Q Mr. Gillan, would you please state your name  
12 and business address for the record?

13 A Joseph Gillan, P.O. Box 541038, Orlando,  
14 Florida 32854.

15 Q By whom are you employed, and in what  
16 capacity?

17 A I'm self-employed as a consultant economist.

18 Q Did you cause to be prepared 53 pages of  
19 direct testimony which was prefiled on behalf of AT&T  
20 in this proceeding on August 16, 1996?

21 A Yes, I did.

22 Q Do you have any changes or corrections to  
23 your testimony?

24 A Yes. I have one change.

25 Q Would you please identify it at this time?

1           **A**     Yes. The change appears on Page 13, Line  
2 25. At the time that I wrote my testimony, I was  
3 under the impression that GTE announced its agreement  
4 to provide long distance service using LDDS WorldCom  
5 four days after the signing of the Act. They actually  
6 announced that within one hour of the Act being signed  
7 into law.

8                         So on Line 25 where it states, "on February  
9 12, 1996," should be stricken and substituted "within  
10 one hour of the Act signing."

11           **Q**     Are those all of your corrections?

12           **A**     Yes, they are.

13           **Q**     If I asked you the same questions today as  
14 are contained in your prefiled direct testimony, with  
15 the correction you've just identified, would your  
16 answers be the same?

17           **A**     Yes, it would.

18                         **MS. DUNSON:** Madam Chairman, I request that  
19 Mr. Gillan's testimony be inserted into the record as  
20 though read.

21                         **CHAIRMAN CLARK:** Mr. Gillan's testimony will  
22 be inserted in the record as though read.

23           **Q**     (By Ms. Dunson) Mr. Gillan, did you also  
24 prepare one exhibit which was attached to your direct  
25 testimony?

1           **A**     Yes.

2           **Q**     Do you have any changes or corrections to  
3 make to that exhibit?

4           **A**     No, I do not.

5                   **MS. DUNSON:** Madam Chairman, I request that  
6 Mr. Gillan's Exhibit JPG-1 be marked for  
7 identification.

8                   **CHAIRMAN CLARK:** It will be marked as  
9 Exhibit 3.

10                           (Exhibit 3 marked for identification.)

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25



1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

**DIRECT TESTIMONY OF**

**JOSEPH GILLAN**

**ON BEHALF OF AT&T COMMUNICATIONS**

**OF THE SOUTHERN STATES, INC.**

**Docket No. 960847 - TP**

**I. QUALIFICATIONS AND PURPOSE OF TESTIMONY**

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

**A.** My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando, Florida 32854.

**Q. WHAT IS YOUR OCCUPATION?**

**A.** I am an economist with a consulting practice specializing in telecommunications. My clients span a range of interests and have included state public utility commissions, consumer advocate organizations, local exchange carriers, competitive access providers and long distance companies.

**Q. PLEASE BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND RELATED EXPERIENCE.**

**A.** I am a graduate of the University of Wyoming where I received B.A. (1978) and M.A. (1979) degrees in economics. My graduate program concentrated on the

1 economics of public utilities and regulated industries.

2

3 In 1980 I joined the Illinois Commerce Commission where I had responsibility for  
4 policy analysis relating to the emergence of competition in regulated markets, in  
5 particular the telecommunications industry. While on the staff of the Commission, I  
6 served on the staff subcommittee for the NARUC Communications Committee and  
7 was appointed to the Research Advisory Council overseeing NARUC's research  
8 arm, the National Regulatory Research Institute.

9

10 In 1985 I left the Commission to join U.S. Switch, a venture firm organized to  
11 develop interexchange access networks in partnership with independent local  
12 telephone companies. At the end of 1986, I resigned my position of Vice President-  
13 Marketing to begin a consulting practice. I currently serve on the Advisory Council  
14 for New Mexico State University's Center for Regulation. A complete listing of my  
15 background, publications and prior testimony is included as Exhibit JPG-1.

16

17 **Q. WHO IS SPONSORING YOUR TESTIMONY IN THIS PROCEEDING?**

18

19 **A.** My testimony is being sponsored by AT&T Communications of the Southern States,  
20 Inc. ("AT&T"). Although sponsored by AT&T, the perspective that I will  
21 emphasize is that of competition in general, and most importantly, the intended  
22 beneficiary of competition, consumers.

23

24 **Q. WHAT IS UNIQUE ABOUT THIS ARBITRATION?**

25

1 A. The single feature that most distinguishes this arbitration is the preferred treatment  
2 that GTE obtained under the Telecommunications Act of 1996. GTE, the nation's  
3 *largest* exchange carrier, and the *monopoly* local service provider in its territory,  
4 was provided immediate entry to the interLATA market without first satisfying *any*  
5 of the actions needed for other carriers to provide local exchange service.

6  
7 Nowhere is the need for the Commission to take the steps necessary to permit local  
8 competition more clear than in the case of GTE. GTE has *no* incentive to open its  
9 markets to competition. The Act uniquely positioned GTE to provide both long  
10 distance and local exchange services. With its pockets full of quid, GTE now has no  
11 corporate reason to live up to the quo imposed by the Act. Only this Commission,  
12 through its decision in this arbitration, can achieve the Act's fundamental intention  
13 to make local markets as competitive as long distance markets.

14  
15 In the testimony which follows, I place great emphasis on establishing conditions for  
16 local competition that are comparable to those in the long distance industry. As  
17 explained below, there is underway a fundamental industry shift towards one-stop  
18 shopping where consumers purchase local and long distance services from a single  
19 provider. GTE has leapfrogged the natural sequence of competitive entry -- first  
20 establish the conditions expected to permit local competition, see if the local  
21 competition develops, then permit the incumbent LEC to provide long distance  
22 service -- by becoming the *only* provider of both long distance and local telephone  
23 services without first taking any of the actions needed to permit other carriers to  
24 provide local service.

25

1 Q. PLEASE SUMMARIZE THE PRINCIPAL CONCLUSIONS OF YOUR  
2 TESTIMONY.

3

4 A. This is the second proceeding to *comprehensively* consider *each* of the entry tools  
5 contemplated by the Act (the first proceeding, of course, is the AT&T/BellSouth  
6 arbitration pending before the Commission). The full mosaic of entry tools are  
7 especially needed here -- and quickly -- because GTE is *already* in the market as a  
8 long distance carrier, not just in downtown Tampa, but throughout its region. To  
9 broadly approach this market, offering service to residential and business customers  
10 alike, AT&T -- and importantly, all other potential entrants -- need the full range of  
11 entry options to which they are entitled under the Act.

12

13 The purpose of my testimony is to emphasize the need for immediate, clear action to  
14 implement the tools Congress provided entrants so that they may compete with GTE  
15 across the full range of services, local and long distance, throughout the GTE  
16 territory. As I explain below, GTE's long distance entry was accomplished quickly,  
17 ubiquitously and simply because the *long distance* industry had already been  
18 restructured to support a multi-vendor, competitive environment. The only way that  
19 the consumers in GTE's territory will face competitive choice among full service  
20 providers is if the Commission creates a similar multi-vendor environment at the  
21 *local* level.

22

23 Specifically, my testimony concludes that:

24

25 ● The fundamental promise of the Act is a competitive environment

1 where consumers enjoy choices for all services. The threshold predicate  
2 to this change is the emergence of local competition -- not on a limited  
3 scale, or for a few fortunate customers -- but on a broad scale to all  
4 residential and business subscribers.

5

6 ● The Act eliminated GTE's legal barrier to providing long distance  
7 service. GTE demonstrated how easily an incumbent LEC can add long  
8 distance service -- called by some the "ultimate" vertical service -- to its  
9 product line, quickly offering service throughout its region at negligible  
10 cost. This entry was made possible because the regulatory and  
11 competitive actions necessary to open the long distance market to  
12 competition are all well behind us. The only way that consumers will  
13 have a *choice* of full service providers, however, is if the barriers to  
14 offering local exchange service fall as well. Making local competition a  
15 reality requires the full implementation of the Act's provisions that  
16 enable entrants to use the existing network to offer competitive services.

17

18 ● Fostering a competitive environment is the principal mechanism  
19 available to the Commission to influence retail rates. The key factor  
20 that will decide the price that consumers pay for local telephone  
21 services will be the price that competing carriers pay GTE for the  
22 wholesale local exchange services which are resold to customers, as  
23 well as the price carriers pay to GTE for unbundled network elements  
24 and local interconnection.

25

- 1           ● Resale of wholesale services and unbundling of network elements will  
2           accelerate the deployment of alternative local networks and yield a far  
3           more competitive environment at the end of the entry process than can  
4           otherwise exist.
- 5
- 6           ● Consumers will consider local competition a failure unless operational  
7           support systems accommodate consumer movement from one local  
8           exchange carrier to another on a level comparable to the process used to  
9           move customers among long distance carriers. Implementing  
10          automated systems that support broad-scale local competition requires  
11          that both entrants (which have the incentive) and GTE (which does not)  
12          design, test, and implement these systems.

13

14          Finally, a reminder that the Commission is effectively playing “catch-up” in this  
15          arbitration. GTE has already entered the long distance market. Congress  
16          established the basic framework for local competition, but this framework will  
17          remain hollow until this Commission implements those provisions that provide  
18          entrants the tools they need to offer consumers in GTE’s territory a choice of full  
19          service providers. The Commission cannot affect GTE’s entry, it can only move to  
20          quickly establish the tools GTE’s rivals need to provide consumers choice.

21

22      **Q.    HOW DOES YOUR TESTIMONY RELATE TO THE TESTIMONY OF**  
23      **OTHER AT&T WITNESSES?**

24

25      **A.    My testimony describes the interrelationship among the requests in AT&T’s**

1 arbitration petition and how these requests fit within an overall strategy to  
2 implement the Act. Other witnesses will provide detailed explanations of AT&T's  
3 requests for wholesale services, unbundling of network elements and local  
4 interconnection; the appropriate economic pricing principles to apply; as well as the  
5 particular dimensions of the operational support systems being requested. My role  
6 is to explain how these carrier-to-carrier issues can be expected to yield tangible  
7 benefits in the prices and choices experienced by consumers.

8

9 **Q. DOES YOUR TESTIMONY REFLECT THE FCC'S RULES**  
10 **IMPLEMENTING SECTIONS 251 AND 252 OF THE ACT?**

11

12 A. No, not completely. On August 8, 1996, the Federal Communications Commission  
13 ("FCC") released its Report and Order in Docket 96-98. Although I have not had an  
14 opportunity to review the Order in detail, it is clear that the basic framework adopted  
15 by the FCC parallels my recommendations here. The Order embraces, and the rules  
16 reflect, the Act's fundamental intention to make local markets as competitive as long  
17 distance markets are today, including the implementation of an operational  
18 infrastructure to support a multi-vendor local environment.

19

20 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

21

22 A. In testimony sections which follow, I:

23

- 24 ● describe the competitive environment envisioned by the Act, with  
25 particular emphasis on its effect on consumer prices and choices, and

- 1 explain how GTE's preferred status threatens this competitive  
2 environment (Section II);  
3  
4 ● explain the particular importance of local services resale to achieving  
5 broad customer choice and accelerated entry (Section III);  
6  
7 ● present the fundamental role of unbundled network elements to  
8 achieving the competitive structure contemplated by the Act (Section  
9 IV);  
10  
11 ● conclude with a discussion of the importance of operational changes  
12 needed to provide consumers with the widest choices with the least  
13 disruption (Section V).  
14

15 **II. ACHIEVING THE COMPETITIVE ENVIRONMENT OF THE**  
16 **TELECOMMUNICATIONS ACT**

17  
18 ***A. The Competitive Environment***

19  
20 **Q. PLEASE DESCRIBE THE LONG-TERM COMPETITIVE EQUILIBRIUM**  
21 **ENVISIONED BY THE ACT.**

22  
23 **A. The long-term competitive environment contemplated by the Act will be quite**  
24 **different from today's structure where regulatory and market conditions define**  
25 **separate long distance and local markets, and carriers are labeled as interexchange**



1 carries ("IXCs"), competitive access providers ("CAPS"), alternative local exchange  
2 carriers ("ALECs"), or local exchange carriers ("LECs"). The environment created  
3 by the Act is intended to enable carriers to offer the full range of services to their  
4 customers, extending the benefits of long distance competition to all market  
5 segments. The Act permitted GTE to benefit immediately from this new  
6 environment, but it also imposed on GTE specific obligations so that a consumer's  
7 choice of a full service provider in GTE's local territory is not limited to only GTE.

8  
9 To effect the transition to a fully competitive environment, Congress adopted a  
10 completely new framework to govern the relationship between GTE (and other  
11 incumbent LECs) and other carriers. This *carrier-to-carrier* framework provides  
12 entrants quite different entitlements -- and imposes on GTE quite different  
13 obligations -- than have existed in the past. This carrier-to-carrier framework  
14 enables entrants to use GTE's existing network to fashion their own local exchange  
15 and exchange access services on an economic basis comparable to GTE.

16  
17 **Q. WHAT ARE THE CORE ELEMENTS OF THE CARRIER-TO-CARRIER**  
18 **FRAMEWORK OUTLINED BY THE ACT?**

19  
20 **A. The core provisions describing these new carrier-to-carrier relationships are**  
21 **contained in Sections 251 and 252 of the Act. In simple terms, these Sections**  
22 **impose on incumbent LECs, including GTE, the obligation to permit the resale of its**  
23 **retail services at wholesale prices, to unbundle its network and sell these elements to**  
24 **entrants at cost-based rates, and to implement a system of reciprocal compensation**  
25 **for the transport and termination of traffic. It is important to understand that these**

1 items form the backbone of the relief AT&T seeks and are not options which GTE  
2 may, or may not, fulfill at its option. Rather, these are clear obligations which  
3 Congress adopted in order to effect a fundamental change in the industry by  
4 promoting robust local competition.

5

6 **Q. WHY WOULD CONGRESS HAVE ADOPTED CARRIER-TO-CARRIER**  
7 **ARRANGEMENTS WHICH PROVIDE ENTRANTS THESE RIGHTS?**

8

9 A. The Act recognized that full retail competition would be seriously delayed, if not  
10 effectively foreclosed, if it first required the building of new competitive exchange  
11 networks. While some limited local networks are under construction, no carrier can  
12 construct ubiquitous local networks capable of supporting broad competition. The  
13 GTE exchange network in Florida is massive, with nearly 2 million access lines  
14 serving virtually every residence and business in its territory.

15

16 Measuring the network solely in terms of loops (i.e., the last connection to the  
17 customer) significantly understates the enormous (in fact, unprecedented)  
18 investment that would be necessary for even a single provider -- much less, the  
19 multiple providers necessary for a fully competitive environment -- to duplicate  
20 GTE's network. In addition to the loop plant to each and every premise in its  
21 territory, GTE's exchange network (as of 1995) encompassed nearly 239 local  
22 switches (including remotes) interconnected by a vast web of interoffice facilities.

23

24 Overall, the GTE network represents more than \$3.7 billion in investment in Florida  
25 alone (Source: 1995 ARMIS 43-01, Total Plant in Service) and is more than \$36

1 billion nationwide. In contrast, AT&T's *worldwide* investment is approximately  
2 \$23 billion. (Source: AT&T 1994 Form M.) Because of the size and geographic  
3 reach of GTE's network -- in fact, every incumbent's network -- Congress  
4 recognized that local competition would develop at a snail's pace unless these  
5 networks could be used by other carriers to provide local exchange and exchange  
6 access services.

7  
8 **Q. ARE THERE OTHER REASONS TO PERMIT OTHER CARRIERS TO USE**  
9 **THE EXISTING EXCHANGE NETWORK TO OFFER THEIR SERVICES?**

10  
11 **A.** Yes. The overarching goal of the Act is to provide consumers with the most choices  
12 at the lowest possible cost. In many areas, this goal can best be satisfied if GTE's  
13 network is used by multiple local providers so that the cost-efficiencies of a single  
14 network can be fully realized. Where the GTE network is the most economic  
15 choice, carriers are permitted to use it; where new investment will lower cost,  
16 carriers may deploy alternatives and interconnect with GTE to provide service. The  
17 result is to achieve the lowest potential cost and, by achieving the most efficient cost  
18 level, provide consumers with the lowest prices possible.

19  
20 This framework of the Act is designed to foster local competition as rapidly and as  
21 broadly as possible. Once the Act is fully implemented, consumers should be able  
22 to select among a number of providers of telecommunication services, obtaining  
23 local and long distance services separately or in a package, and shifting between  
24 local carriers with the same ease that they today choose their long distance carrier.  
25 For consumers to enjoy this choice, however, entrants must have the same ability to

1 craft services using the GTE network that GTE itself enjoys. Because GTE is  
2 already in a position to offer local and long distance services, the Commission must  
3 rapidly open GTE's network to other providers so that they may offer local exchange  
4 services as well.

5

6

***B. Restoring Competitive Balance***

7

8 **Q. WHY IS IT IMPORTANT TO REDUCE LOCAL ENTRY BARRIERS**  
9 **QUICKLY?**

10

11 **A. The Act provided GTE preferential treatment that distorts competition and denies**  
12 **consumers in its territory competitive choice. GTE's experience proves that it is**  
13 **simple for an incumbent LEC to offer long distance services, while the tools needed**  
14 **for others to provide local service are not yet created, much less created equally.**

15

16 **Unlike the very real obstacles to local competition faced by rivals, the barriers that**  
17 **confronted GTE essentially were eliminated "at the stroke of a pen." The barriers to**  
18 **GTE offering long distance service were minimal because there is competition at**  
19 ***both* the retail and wholesale levels in that market. At the wholesale level, a variety**  
20 **of companies compete to provide the central ingredients of long distance service --**  
21 **transmission, switching, and billing. In effect, the long distance equivalents to**  
22 **unbundled network elements and the resale of wholesale services are already in**  
23 **place.**

24

25 **A new entrant to the long distance market need not construct its own network or**

1 wait for the development of back-office systems to offer its services. Systems to  
 2 move customers rapidly between long distance carriers -- i.e., changing a customer's  
 3 primary interexchange carrier or PIC -- are already sized to process large numbers  
 4 of consumer requests. The industry has in place the necessary infrastructure to  
 5 support a multi-vendor, competitive long distance environment.

6

7 **Q. IS GTE BENEFITING FROM THIS MULTI-VENDOR**  
 8 **INFRASTRUCTURE?**

9

10 A. Yes. GTE is now benefiting from the fruits of the long distance industry's history  
 11 with competition. GTE was able to begin to offer long distance services without  
 12 investing in a single switch or strand of optical fiber, obtaining a single right of way,  
 13 or negotiating a single interconnection agreement with a recalcitrant monopolist.  
 14 GTE only had to choose its underlying interexchange carrier and begin marketing  
 15 long distance services to its preexisting base of local customers, which today, is the  
 16 *entire* market in its exchanges. As it attracts these customers, GTE is able to easily  
 17 move customers from their existing long distance carriers using the PIC-change  
 18 process that the long distance industry paid to have developed and implemented.

19

20 **Q. HOW LONG DID IT TAKE FOR GTE TO ESTABLISH ITS LONG**  
 21 **DISTANCE OPERATIONS?**

22

23 A. The Telecommunications Act of 1996 was enacted into law on February 8, 1996.  
 24 GTE announced its agreement to offer long distance services under an agreement  
 25 with LDDS WorldCom <sup>within one hour of the Act signing</sup> on ~~February 12, 1996~~. GTE's tariff describing its flagship

1 long distance service, the Easy Savings Plan, became effective on March 19, 1996.  
2 And GTE was aggressively marketing long distance service by May, 1996. From  
3 the Act's enactment to GTE's operation was less than four months.  
4

5 **Q. IS THERE EVIDENCE SUPPORTING YOUR CLAIM THAT GTE NOW**  
6 **ENJOYS A ONE-SIDED ADVANTAGE?**

7  
8 **A. Yes. GTE's special opportunity is well recognized by its management and Wall**  
9 **Street analysts. As Merrill Lynch (May 14, 1996) so clearly summarized:**

10

11 GTE has already begun to offer long distance services to its in-  
12 region customers and intends to gain 10% of its \$4.8 billion  
13 addressable long distance market within 12 months with negligible  
14 cost to the bottom line. GTE management presentations at its  
15 quarterly analyst meeting reiterated the company's plans to achieve  
16 10% EPS growth for the foreseeable future, despite the "negligible"  
17 startup cost of long distance entry. We also learned the company  
18 believes its long distance effort will generate positive earnings  
19 impact in 1997, which reflects, in our view, the remarkably  
20 attractive economics facing an RBOC entering an adjacent market  
21 (long distance). How often is it that an industry wakes up one day,  
22 finds its addressable market expanded by 40% and can launch the  
23 new service without noticeable dilution and achieve positive  
24 earnings by the second year?

25

1 This analysis embodies every conclusion of the market dynamic I have described  
2 above. GTE expects to gain share rapidly. GTE expects to do so with negligible  
3 costs. GTE's opportunity is *immediate* higher profits and market share. In fact,  
4 GTE's management expects its profitability to grow for the "foreseeable future," a  
5 period which must include this arbitration and the local entry that should result.

6

7 **Q. HOW IS GTE USING ITS HEAD START?**

8

9 A. GTE is exploiting its head start by encouraging customers to sign contracts with 1, 2  
10 and 3 year terms. These contracts enable GTE to translate its immediate advantage  
11 to a long-term gain by locking customers into contracts while GTE is the only  
12 provider able to offer local and long distance services as a package.

13

14 **Q. WHAT IS THE EFFECT OF GTE'S ENTRY INTO THE LONG DISTANCE**  
15 **MARKET WITHOUT FIRST ESTABLISHING WIDE-SCALE LOCAL**  
16 **COMPETITION?**

17

18 A. GTE's entry proves that a substantial portion of the market prefers to obtain its  
19 telecommunications services as a package. Its management expects to gain 10% of  
20 the market in 12 short months, and that its earnings will continue to improve by 10%  
21 per year for the foreseeable future. At this pace, GTE would obtain a market share  
22 comparable to this industry's most successful entrant, MCI. But it took MCI two  
23 *decades* to reach the same level that GTE now expects to reach in two *years*.

24

25 This begs the obvious question: Why would GTE be so successful? Is it the quality

1 of its long distance network? If this were the answer, then LDDS WorldCom, on  
2 whose network GTE provides service, would similarly gain 10% of the market per  
3 year. No, the answer is quite clear: GTE is reaping the advantage of an incumbent  
4 local exchange carrier that is able to provide local and long distance services while  
5 no other competitor has the opportunity to respond.

6  
7 **Q. WHAT WOULD BE THE LONG TERM IMPACT IF THIS COMPETITIVE**  
8 **IMBALANCE WERE PERMITTED TO CONTINUE?**

9  
10 A. The long term impact would be a decline in long distance competition. Local  
11 exchange service is likely to become a compulsory element of the basic package  
12 that carriers must offer to remain competitive. Local service *must* be made  
13 competitive or competition for other services, including long distance, will suffer.  
14 GTE cannot be the consumers' only full service choice or competition will fail, and  
15 with its failure, the principal protection that consumers may have from monopoly  
16 pricing will fail.

17  
18 A reduction in *long distance* competition because of a failure to establish *local*  
19 competition is not what Congress intended or consumers deserve. The Act provided  
20 -- prematurely, in my view -- GTE the ability to offer long distance service, but it  
21 also imposed on GTE a clear obligation to open its network and permit the resale of  
22 its services so that other carriers will be able to offer packages of local and long  
23 distance service as easily as GTE.

24  
25 ***C. The Tools of Comprehensive Entry: Resale and Network Elements***



1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

**Q. HOW WILL OTHER CARRIERS BE ABLE TO PROVIDE COMPETITIVE LOCAL SERVICES?**

A. Congress recognized the massive dominance of the incumbent LEC's network and the reality that it will take many years for the local transmission (especially loop) market to become as competitive as the interexchange transmission market.

Alternative networks will take time to develop. As a result, the Act provides for a number of entry strategies that rely, to one extent or another, on the immediate use of the incumbent's facilities and services by other providers, so that local competition may develop quickly.

Each of these strategies can be found in the central components of AT&T's requests that led to this arbitration. These key components include AT&T's request to:

- resell wholesale equivalents of GTE's retail services,
- provide local exchange and exchange access services using network elements obtained from GTE as basic ingredients to AT&T's services, and
- transport and terminate traffic under reciprocal compensation arrangements.

In later sections of my testimony, I address more extensively the importance of

1 wholesale services (Section III) and network elements (Section IV) to providing  
2 exchange services. The point that I would like to emphasize here is the significance  
3 of *comprehensively* establishing the basic conditions of local competition quickly so  
4 that consumers may enjoy a choice of full service provider.

5

6 **Q. WHY IS AT&T'S REQUEST SO COMPREHENSIVE?**

7

8 **A.** One of the distinguishing features of this arbitration -- like the AT&T/BellSouth  
9 arbitration which precedes it -- is its breadth. The importance of comprehensively  
10 establishing each of the entry tools contemplated by the Act is especially critical in  
11 the context of GTE, an incumbent LEC that has crossed the line to full service  
12 provider.

13

14 The GTE territory is representative of the entire Florida market, encompassing both  
15 metropolitan business districts and rural communities. Significantly, AT&T  
16 provides long distance service to a broad cross-section of customers, geographically  
17 scattered across the full range of market and network conditions. There are no  
18 barriers to GTE's offering its long distance services *anywhere* in this region; for  
19 consumers to have a choice of full service provider, however, AT&T (and others)  
20 must similarly be able to offer local services throughout GTE's territory.

21

22 Importantly, no single entry vehicle is best suited for every customer and geographic  
23 consideration. Some strategies -- loop resale for instance -- are particularly ill-  
24 suited for mass application because they either require physical circuit  
25 rearrangements as customers move between providers or presuppose the extensive

1 deployment of alternative networks which do not now exist. Broad entry requires  
2 that the full range of entry strategies be available so that a carrier may tailor its  
3 offerings to particular conditions.

4  
5 Because AT&T's request is so comprehensive, its value extends beyond this single  
6 entrant to an entire industry. By encompassing all possible entry strategies, AT&T's  
7 request necessarily includes the individual approaches that other carriers will use to  
8 address their markets. This observation is particularly important. By deciding the  
9 AT&T arbitration, the Commission is establishing the conditions of entry not just  
10 for AT&T, but effectively defining the entry conditions for any entrant that will use  
11 all (or part) of GTE's network to provide local services.

12

13 **Q. DOES COMPREHENSIVE ENTRY ALSO REQUIRE NEW OPERATING**  
14 **SYSTEMS?**

15

16 **A. Yes. Just as the development of meaningful long distance competition required new**  
17 **systems to support a multi-vendor environment, meaningful local competition will**  
18 **not succeed without a similar commitment of industry resources to operational**  
19 **support. Consumers will widely perceive local competition -- and the Congressional**  
20 **action upon which it relies -- as a failure if changing local telephone companies is**  
21 **associated with extended delays, high costs, periods of outage, unreliable bills, or**  
22 **disrupted services. Operational systems are absolutely critical to robust competition**  
23 **in the local exchange market.**

24

25 The process with which consumers are familiar -- and which GTE is using to enter

1 the long distance market -- allows consumers to change long distance carriers (i.e.,  
2 their primary interexchange carrier, or "PIC") with a simple telephone call or stroke  
3 of the pen. It is an easy, streamlined process. The operating standards of this  
4 process, in terms of cost, speed and accuracy, must become the standard for judging  
5 systems used to change local service providers as well.

6

7 **Q. WHAT ARE THE BASIC WAYS IN WHICH AT&T (INDEED, ANY**  
8 **ENTRANT) IS LIKELY TO COMPREHENSIVELY SERVE THE MARKET?**

9

10 A. There are three basic entry tools created by the Act. The first involves the resale of  
11 GTE's retail services at wholesale rates. This entry tool (described more fully in  
12 Section III) should permit carriers to quickly enter the market, but there are limits to  
13 its usefulness because it permits only limited price competition and little product  
14 differentiation.

15

16 Second, entrants are able to configure their own exchange networks using  
17 components of GTE's network, including combinations that rely entirely on GTE's  
18 network. Providing local exchange service using unbundled network provides  
19 entrants a far broader ability to define their own services, develop the unique skills  
20 of a local exchange carrier, and set the stage to sequentially deploy a local network  
21 by replacing elements obtained from GTE with its own. For simplicity, I will refer  
22 to this entry strategy as the network-element approach (described in Section IV),  
23 although it also requires that the entrant obtain transport and termination from GTE  
24 to complete local calls.

25

1 Finally, entrants will deploy their own facilities. This final step will take time and, in  
2 some areas, may never be an economic choice. As a result, the Commission's  
3 principal role under the Act will be assuring that GTE's network is available to other  
4 competitors, at cost-based rates, to provide consumers service choices and lower  
5 prices.

6  
7 ***D. Local Entry And Consumer Prices***

8  
9 **Q. HOW WILL THE COMPETITIVE ENVIRONMENT CREATED BY THE**  
10 **ACT BENEFIT CONSUMERS?**

11  
12 A. The Act is fundamentally about choice. Choice for consumers is made possible  
13 through the carrier-to-carrier arrangements that will underlie the service offerings of  
14 new competitors. This is why correctly arbitrating carrier-to-carrier arrangements is  
15 so important -- these agreements ultimately translate to the choices and price levels  
16 that consumers experience. Much as the visible contours of the earth's surface (its  
17 mountains, valleys and plains) are determined by underlying geographic conditions,  
18 so too will *consumer* choices and prices be decided by the underlying conditions of  
19 these *carrier-to-carrier* arrangements.

20  
21 **Q. HOW WILL THE PRICES GTE CHARGES CARRIERS FOR UNBUNDLED**  
22 **NETWORK ELEMENTS, INTERCONNECTION AND TRANSPORT AND**  
23 **TERMINATION ON ITS NETWORK INFLUENCE RETAIL RATES?**

24  
25 A. GTE's competitors will use unbundled network elements, interconnection and

1 transport and termination to provide local exchange services to consumers and  
2 exchange access services to other carriers. For simplicity, I will refer to the price of  
3 these components -- i.e., unbundled network elements, interconnection, and  
4 transport and termination -- as carrier-network charges. With correctly priced  
5 carrier-network charges (which is to say, prices based on economic cost), these  
6 entrants will be able to offer -- and competition will force them to offer -- local  
7 exchange services at prices no higher than today's prevailing (i.e., GTE's) rates.

8  
9 Importantly, once competition is established in this manner, the existence of  
10 multiple providers of local exchange services will constrain GTE's own pricing  
11 behavior. GTE will not be able to raise local exchange prices to consumers because  
12 these consumers will have a choice of other providers. There is simply no consumer  
13 protection stronger than the ability to "take your business elsewhere."

14  
15 This logic, while simple, is so important that it bears repeating. As entrants first  
16 approach the market, they are constrained by GTE's retail prices. The entrant must  
17 provide service at competitive prices in order to attract and retain customers. Cost-  
18 based carrier-network charges should provide this ability because both the entrant  
19 and GTE would incur the same cost for the underlying network used to provide  
20 service. If GTE can profitably provide service at today's rates, then so too should  
21 the entrant. Having entered the market, these entrants then become the constraint on  
22 GTE's prices, limiting GTE's ability to raise rates in the future.

23  
24 However, the entire basis for the above conclusion is that the unbundled network  
25 elements, interconnection and termination arrangements used by the entrant are

1           priced at economic cost. If so, then the entrant and GTE each will face the same  
2           underlying cost of the facilities needed to provide service. So long as these carrier-  
3           network prices facilitate profitable initial entry, then competition should provide  
4           sustained pressure on price levels in the future.

5

6   **Q.    WHAT WOULD HAPPEN IF THESE PRICES ARE INFLATED ABOVE**  
7   **THEIR COSTS?**

8

9   A.    The result would be higher consumer prices and fewer choices. GTE would be able  
10       to increase the costs of its rivals, limiting their ability to compete with lower prices.

11

12   **Q.    IS THIS WHY THE COMMISSION SHOULD MAKE SURE THAT**  
13   **UNBUNDLED NETWORK ELEMENTS, INTERCONNECTION AND**  
14   **TERMINATION PRICES ARE ESTABLISHED CORRECTLY?**

15

16   A.    Yes. The Act represents a fundamental shift in regulatory focus from *directly*  
17       setting retail prices and service dimensions (such as the size of local calling areas) of  
18       local exchange carriers, to *indirectly* influencing retail services through the review  
19       of the underlying carrier-to-carrier arrangements. If unbundled network element  
20       interconnection and termination prices are correctly established, then both GTE and  
21       other providers will be able to compete upon a common foundation, at least with  
22       respect to the cost of the underlying network.

23

24   **Q.    WHAT WOULD HAPPEN TO THE PRICE OF RESIDENTIAL LOCAL**  
25   **EXCHANGE SERVICE IF IT IS CURRENTLY PRICED BELOW COST?**

1

2 A. The answer to this question has both a short and long run component. For the sake  
3 of discussion, *assume* that residential local exchange prices do depend upon the  
4 excessive pricing of other services, principally access charges. (This is a claim that  
5 I do not necessarily accept, but I will not dispute here).

6

7 In the short-run, entrants are likely to provide services either through resale or  
8 through a heavy, perhaps complete, reliance on network elements obtained from  
9 GTE. In the resale scenario, GTE *retains* all access revenues, even those of the  
10 reseller's customers. This arrangement seriously undermines the usefulness of  
11 resale to the entrant (discussed in more detail in Section III below), but at least it  
12 eliminates any claimed pressure by GTE to increase its local rates.

13

14 In the scenario where the entrant provides local services using unbundled network  
15 elements, the entrant fully compensates GTE for the economic cost of the facilities  
16 and the entrant provides the access service. If GTE is correct that local rates are  
17 below cost, then both GTE and the entrant (who has paid GTE for the cost of its  
18 facilities) will have a revenue shortfall. But, in this scenario, both GTE and the  
19 entrant have the respective access revenues from their own customers to offset any  
20 revenue shortfall, again eliminating any alleged need for local rates to increase.

21

22 However, in the long run, the competitive environment envisioned by the Act (if not  
23 the plain language of the Act itself) requires that all carrier-to-carrier prices be  
24 nondiscriminatory and cost based. This means that the excessive revenues currently  
25 embedded in access charges must end. If long term support to local rates is



1 determined to be needed, then such support must be explicitly provided through a  
2 universal service fund. Of course, any such funding must be equally available to  
3 both the entrant and GTE so as to not disrupt the consumer's choice of provider.  
4 The Act requires that any universal service mechanism be explicit and  
5 nondiscriminatory.

6

7

*E. Entry and Facilities Deployment*

8

9 **Q. IF CARRIERS CAN OFFER SERVICES USING GTE'S NETWORK, WILL**  
10 **THEY ALSO CONSTRUCT COMPETING NETWORKS?**

11

12 **A.** Certainly, but local facilities deployment is a longer-term proposition. It took more  
13 than 100 years to construct these local networks and the Commission should not  
14 expect entrants to deploy comparable networks overnight. No company employing  
15 sound business judgment would expend the type of capital it will take to deploy  
16 extensive local networks without strong evidence that it can succeed in this market.  
17 In this respect, wholesale services and unbundled network elements permit carriers  
18 to begin operation and gain needed experience to more efficiently design and plan  
19 investment strategies.

20

21 In addition, entry using GTE's network will permit entrants to build the necessary  
22 revenue streams to justify the massive investment necessary to construct even  
23 relatively modest local networks. It is useful to remember that the gross plant of  
24 GTE nationwide is more than \$36 billion (Source: 1995 ARMIS 43.01), 50% larger  
25 than that of AT&T. This buildup of local plant took place over decades, not

1 overnight.

2

3 As entrants build their base of customers using wholesale services and unbundled  
4 network elements, only then will they be able to make rational investment decisions  
5 concerning where to construct networks, invest in switching, add new capabilities,  
6 etc. Teleport, in fact, has publicly stated that its business strategy is to win  
7 customers first and then build facilities in an efficient way to serve them  
8 (Telecommunications Reports, October 16, 1995, page 20). With tangible market  
9 experience and a strong customer base, entrants are more easily able to raise capital,  
10 and just as importantly, convince their shareholders of the wisdom of their actions,  
11 thereby accelerating the deployment of alternative networks.

12

13 **Q. DOES THIS PROCESS PARALLEL THE DEVELOPMENT OF FACILITIES**  
14 **COMPETITION IN THE LONG DISTANCE MARKET?**

15

16 **A.** Yes. In the long distance market, early entrants like MCI were able to expand their  
17 services and customer base by reselling services off of AT&T's network. This  
18 growth financially justified the deployment of their own networks providing internal  
19 investment capital and shareholder confidence, and encouraged the entry of others,  
20 including (what is now) the third major network provider, Sprint. Later, the  
21 continued growth of the resale market resulted in the construction of the fourth  
22 national network (WilTel) for the express purpose of providing wholesale carrier -  
23 to-carrier services, as opposed to retail services, for use by the "resale" industry.

24

25 **Q. DO YOU EXPECT CARRIERS WILL REPLICATE GTE'S ENTIRE**

**NETWORK?**

A. No. It is likely that some portions of the network may never see a competitive alternative, certainly in the next several years. For instance, it is easy to visualize significant resistance on the part of residential homeowners to multiple network interface boxes being installed on their premises to reflect previous, and future, competitive choices in local services. Other elements of the network may best be provisioned by a sole network vendor (for instance, the loop and local switching in many areas). The point is not simply to encourage new construction -- the goal is to encourage efficient facilities deployment. Wholesale services and correctly priced unbundled network elements, that is to say economically priced unbundled network elements, are key elements of this transition.

**III. LOCAL SERVICES RESALE*****A. The Role of Local Services Resale*****Q. WHAT IS LOCAL SERVICES RESALE?**

A. Local services resale is the purchase of an incumbent LECs services by a competing local service carrier on a wholesale basis with the intent to resell these services to consumers. Wholesale local services are expressly designed, supported, and *priced* to be resold by another carrier in the retail market. These wholesale local services provide multiple entrants a simple means to begin offering local exchange services and attract customers. GTE is required to offer its local services for resale at

1 wholesale rates under Section 251(c)(4) of the Act.

2

3 **Q. WILL LOCAL SERVICES RESALE PROVIDE IMMEDIATE CONSUMER**  
4 **BENEFITS?**

5

6 **A. Yes. In the long distance marketplace today, many carriers buy long distance**  
7 **services at wholesale rates for purposes of reselling them to customers, and compete**  
8 **by differentiating their billing systems, customer support and other elements of**  
9 **services. This same strategy can be extended to the local marketplace, with carriers**  
10 **using their marketing and customer skills to resell services obtained from the**  
11 **incumbent LEC.**

12

13 The utility of local services resale as a means to support broad entry has been  
14 verified by the Rochester Telephone Company experiment. The Rochester  
15 experiment is best known for exposing the importance of operational support  
16 systems and the need for a viable discount. The Rochester Telephone Company was  
17 unable to support local resale on a mass market basis, and the experimental 5%  
18 discount showed the importance of correct pricing. Ultimately, AT&T had to stop  
19 soliciting customers until the Rochester Telephone Company could establish support  
20 systems and the New York Commission established a more reasonable differential  
21 between retail and wholesale services.

22

23 The deficiencies in the Rochester experiment are well documented and widely  
24 understood. But there are other, more subtle, lessons from the Rochester experiment  
25 that should not be overlooked. Foremost is that Rochester did prove the usefulness

1 of local resale as a way to enter a market quickly and offer customers a choice of  
2 local providers. AT&T was able to offer service throughout the territory, while  
3 other entrants remained confined to multi-tenant buildings. Equally telling,  
4 however, is that the operational and pricing problems caused AT&T to terminate its  
5 marketing, demonstrating that establishing conditions that will *sustain* competition is  
6 just as important as *permitting* the entry itself.

7  
8 **Q. WILL LOCAL SERVICES RESALE PROVIDE AN EFFECTIVE CHECK**  
9 **ON GTE'S PRICING?**

10  
11 **A. Only in small ways. Requiring GTE to provide wholesale local exchange services**  
12 **will limit its ability to discriminate between classes of customers, except where the**  
13 **Commission has blessed such discrimination to satisfy a unique public need (such**  
14 **as, for instance, preventing lifeline services from being offered outside the targeted**  
15 **class).**

16  
17 Wholesale services, however, will not police the overall level of rates as effectively  
18 as the pricing of unbundled network elements, interconnection, transport and  
19 termination as discussed earlier in this testimony. This is because the wholesale  
20 price is calculated off the retail rate. As retail prices move up, so too do wholesale  
21 rate levels, and price competition is constrained by the differential. As a result, only  
22 limited price competition is made possible by reselling wholesale services. Thus,  
23 the need to regulate GTE's retail rates remains unchanged.

24  
25 **Q. SHOULD ALL RETAIL SERVICES HAVE A WHOLESALE**

1           **EQUIVALENT?**

2

3    A.    Yes. There are a number of strategies that GTE could use to limit the usefulness of  
4           the wholesale option. In particular, as noted by AT&T witness L.G. Sather, GTE  
5           proposed to AT&T several exclusions to its wholesale pricing and resale  
6           obligations.

7

8           These exclusions could be used by GTE to evade its wholesale obligation by  
9           selectively targeting customers for special pricing, rolling promotions, and  
10          grandfathering, which is a more polite phrase for warehousing, large sections of the  
11          market. Together, these exclusions could eliminate or greatly reduce the wholesale  
12          option as an entry option.

13

14   **Q.    WHAT IS THE BASIC APPROACH TO CALCULATING THE**  
15   **WHOLESALE PRICE FOR LOCAL SERVICES?**

16

17   A.    The basic approach is to remove from the retail price an estimate of the retail-related  
18          costs that will be avoided by GTE as a wholesaler of services. AT&T witness  
19          Lerma's testimony deals with the calculation of these avoided costs.

20

21   **Q.    WHAT WOULD OCCUR IF THE COMMISSION DOES NOT FULLY**  
22   **REMOVE THESE RETAILING COSTS WHEN ESTABLISHING THE**  
23   **WHOLESALE RATE?**

24

25   A.    Failing to fully remove retail costs would create a wholesale rate level that is too

1 high. This would distort competition and artificially depress entry. The effect  
2 would be to deny consumers the benefits of competition -- lower prices, more  
3 choices and the ability to vote their dollar between rivals vying for their attention.

4  
5 It is useful to remember that although the immediate recipient of a wholesale  
6 discount is the local reseller, the ultimate beneficiaries are consumers. An  
7 artificially low wholesale discount will not lead to lower retail prices. In other  
8 words, the smaller the discount, the less competitive pressure to lower prices.

9  
10 **Q. ARE THERE ANY MARKET BENCHMARKS TO JUDGE THE**  
11 **REASONABLENESS OF THE PROPOSED DISCOUNTS?**

12  
13 **A.** Yes. In the long distance market there is a competitive wholesale market that  
14 actively solicits retail carriers with attractive wholesale pricing and operational  
15 systems specifically designed for resale. It is useful to consider the discounts that  
16 the LECs have trumpeted to Wall Street analysts to place the local wholesale  
17 discounts discussed in this proceeding into context.

18  
19 For instance, NYNEX recently indicated to Wall Street analysts that it anticipated a  
20 80% discount on the long distance services it buys at wholesale. (Source: Dean  
21 Witter, November 6, 1995.) Further, Merrill Lynch (Merrill Lynch, August 24,  
22 1995) states:

23  
24 . . . reseller spreads in long distance are already huge (50%) given  
25 the existence of four fiercely competitive long distance networks.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

Merrill Lynch also predicts that:

For calls terminating outside an individual RBOC's franchise area, that RBOC will be able to bargain for volume discounts given that its volumes are likely to exceed that of any other long distance customer in that region -- *discounts that are likely to grow over time as RBOC long distance shares and thus negotiating leverage grows.*

Emphasis added.

The point here is simple: where *competition* decides the wholesale discount, that discount is large and is expected to increase.

***B. The Dilutive Effect of Access Charges on the Wholesale Discount***

**Q. DO YOU BELIEVE THAT THE DISCOUNT ESTIMATED BY AT&T WILL BE SUFFICIENT TO FOSTER LOCAL ENTRY?**

**A. No. Even though a discount of this level would apparently comply with the avoided-cost standard of the Act, the Commission should be aware that the interplay between local resale and access service (i.e., the charges GTE imposes on long distance companies) will significantly reduce the viability of local resale. This is because GTE would continue to charge a reseller-entrant carrier access charges, even to originate or terminate traffic to the reseller's own customers. As explained below, this arrangement diminishes the attractiveness of local resale.**



1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

**Q. PLEASE DESCRIBE THE RELATIONSHIP BETWEEN ACCESS CHARGES AND THE WHOLESALE PRICES.**

A. With local resale, GTE remains the access provider even to the customers that have "left" and become customers of the reseller. Because access charges are priced above cost, GTE is able to retain much of the profits from a customer, even after it has lost its retail business. In effect, this means that the reseller markets the relatively less profitable service (local service), while GTE retains the cream (access service). This situation is somewhat analogous to agreeing with Gillette to market its razor handles, while Gillette retains a monopoly on the blades. Sound competition cannot proceed on this basis.

**Q. WHAT IS THE EFFECT OF GTE'S RETAINING AN ACCESS MONOPOLY TO THE RESELLER'S CUSTOMERS?**

A. One way of measuring the impact of this arrangement is to calculate an "effective" wholesale discount that not only considers what the interexchange carrier/local reseller pays for the wholesale local exchange service, but also includes the access charges that the interexchange-carrier/local-reseller continues to pay GTE. This "effective" discount can then be compared to the nominal discount; i.e., the discount that considers only the price paid for the wholesale local exchange service.

When access charges are included in the equation, the effective discount is reduced substantially. For instance, if the nominal discount is 30%, GTE does not receive

1 30% less revenue for each customer that moves to a reseller because it continues to  
2 receive access revenues. For the *average* customer, if the nominal discount is 30%  
3 the effective discount to GTE is only 17.3%. This comparison understates the  
4 effect of access, however, since it is calculated for the *average* customer. The  
5 dilutive effect increases as the average toll usage of the reseller increases because  
6 higher toll users cause higher access charges to be paid by the long distance carrier  
7 to the incumbent LEC. Consequently, even when nominal wholesale discount levels  
8 appear large, the realized differential remains relatively small once access charges  
9 are taken into consideration.

10

11 The magnitude of this problem should not be underestimated. For the purpose of  
12 comparison, consider the combined effect of a 30.9% wholesale discount (as  
13 suggested by AT&T) and current access charges. On average, the reseller's margin  
14 would be approximately \$7.60 for each subscriber line it attracted, while GTE  
15 would retain approximately \$18.00 per month in access revenues, even from the  
16 customers that it lost.

17

18 No matter how diligently the Commission removes retail-related costs from GTE's  
19 wholesale prices, the above-cost pricing of access will distort a reseller's ability to  
20 compete with GTE. GTE recovers its costs in the price of *both* local/retail service  
21 and access service, while its competitors must recover all their costs solely through  
22 the wholesale discount. As the Department of Justice noted (CC Docket No. 96-98,  
23 page 39):

24

25 The economics of a competitive [local] marketplace would not

1 support entry solely on the revenues derived from local exchange  
2 service.

3  
4 Similarly, local competition based on the resale of wholesale services will not  
5 succeed so long as the access charges which the local exchange carrier continues to  
6 receive from the reseller are a principal source of local profit. Real competition  
7 requires that both the entrant and incumbent face the same cost for the facilities used  
8 to provide service and have the same opportunity to recover those costs.

9

#### 10 **IV. UNBUNDLED NETWORK ELEMENTS**

11

##### 12 *A. The Nature of Unbundling*

13

14 **Q. PLEASE DEFINE "UNBUNDLING."**

15

16 **A. Unbundling refers to the offering of discrete elements of the incumbent's network as**  
17 **generic functionalities, not as finished services. These network elements are**  
18 **"unbundled," both from each other and from the retail services of the incumbent**  
19 **LEC.**

20

21 **A useful metaphor for unbundling is that of the "Chinese Restaurant." Chinese**  
22 **restaurants typically have extensive menus, detailing dozens of selections. Yet, in**  
23 **the kitchen, only a few basic ingredients are used to create all these choices.**

24 **Similarly, telecommunications services are typically constructed from a limited**  
25 **number of key ingredients (switching and transmission are the most basic), but the**

1 variety of services (from the consumer's perspective) can be quite extensive.

2

3 Unbundling represents the availability of the incumbent's network elements as

4 ingredients to other providers so that they may combine these ingredients

5 (sometimes adding their own, sometimes not) to provide their own finished services.

6

7 **Q. IS UNBUNDLING THE SAME AS RESALE?**

8

9 A. No. Resale involves the purchase of *finished services* by the reseller from the  
10 incumbent LEC (albeit at wholesale rates) which are then resold by the reseller.

11 Unbundling is the purchase of underlying *network elements* -- which may be  
12 facilities, functions or capabilities -- that can be combined to offer services, either  
13 equal to, or different from, the services of the incumbent LEC.

14

15 **Q. WHAT ARE THE POTENTIAL BENEFITS FROM UNBUNDLING?**

16

17 A. There are three primary benefits. First, opening the incumbent's network to other  
18 carriers as a menu of generic ingredients will make robust competition possible  
19 despite the dominance, if not complete monopoly, of the incumbent LEC's network.  
20 New entrants could fashion service packages not now available, providing  
21 consumers additional choices.

22

23 Second, unbundling allows carriers to sequentially replace individual components of  
24 GTE's network as competitive networks slowly develop. The enormity of GTE's  
25 network necessarily implies that the process of facilities deployment will take time,

1 and will occur unevenly throughout its region. However, through unbundling,  
2 carriers will have an opportunity to develop markets, establish services, and attract  
3 consumers on a timely basis in the *entire* market, with the process of facilities-  
4 deployment following wherever economic.

5  
6 Third, with unbundling there will be substantially more choices at the end of the  
7 process than would result if each individual entrant had to construct network  
8 facilities in order to offer services. Unbundling prevents local network deployment  
9 from becoming a prerequisite to offering service, both for today's entrants and new  
10 providers that may form in the future. By creating an open entry environment,  
11 investment capital can be directed to developing new services and applications,  
12 rather than used exclusively to replicate transmission and switching facilities. By  
13 reducing, and then keeping, barriers to entry low, the most diverse competitive  
14 environment will develop.

15  
16 Thus, unbundling has the potential for *immediate, transitional and long lasting*  
17 benefits for the market and Florida consumers. What matters most at the end of the  
18 process is that multiple carriers have the opportunity to broadly approach the Florida  
19 marketplace, designing services which they believe best satisfy the needs of their  
20 customers, on an economic basis similar to that of the incumbent LEC, and fully  
21 supported by operational systems which will easily accommodate choices by  
22 consumers.

23  
24 A full description of the most fundamental elements that should be unbundled  
25 immediately is identified in the testimony of AT&T Witness Ray Crafton.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

***B. Network Element Pricing***

**Q. HOW SHOULD NETWORK ELEMENT PRICES BE ESTABLISHED?**

A. Network element prices set at direct economic costs will yield the greatest choice and benefits to Florida consumers. To maximize competition -- that is, to promote an environment that will present Florida consumers with the greatest diversity of pricing plans, calling options, and service features -- it is important that the underlying exchange network be available to *all* retail providers of local exchange services on the same terms, conditions and prices.

There are only two ways to assure that all providers have access to the exchange network on equivalent terms. The first is to prohibit the network owner from offering competitive services at all. This was the basic approach that underlaid divestiture; for obvious reasons I am not recommending that action here.

In the absence of such structural protection, the only viable mechanism is to establish prices of the underlying network components at their economic resource cost. The key is to make the network available to all providers on equivalent terms. For the incumbent LEC, this is the element's economic cost, i.e., its total service long run incremental cost ("TSLRIC"). So that all providers face the *same* effective cost for the use of a network component, the *price* charged other carriers must be equal to the economic *cost* of the element in question. Dr. Kaserman's testimony provides additional details concerning the appropriateness of TSLRIC pricing for

1 network elements.

2

3 **Q. DOES PRICING NETWORK ELEMENTS AT TSLRIC IMPLY THAT GTE**  
4 **WOULD NOT BE ALLOWED TO EARN A PROFIT OR COVER ALL OF**  
5 **ITS COSTS?**

6

7 **A. No. First, economic pricing includes a return on investment sufficient to attract and**  
8 **retain capital. Although commonly referred to as "profit," the "cost of capital" is a**  
9 **legitimate economic cost and is included in TSLRIC.**

10

11 **Second, the economic cost of network elements would include costs associated with**  
12 **planning, engineering and operating GTE's network, including costs which are**  
13 **shared by more than one network element (such as the salary of the Operations**  
14 **Director). In the context of retail services, these costs would be viewed as**  
15 **"common," and would not be included in the economic cost of any particular**  
16 **service. Because of this historical context, the Commission may mistakenly assume**  
17 **that the economic costing of network elements would leave a number of "costs"**  
18 **unrecovered.**

19

20 **Importantly, however, perceptions concerning common costs derived in an**  
21 **environment of *retail* costing are not applicable to the costing of *network elements*.**  
22 **For example, consider the salary of a switch technician. In a typical *retail* cost**  
23 **analysis, this cost would be considered common to each of the GTE's retail services**  
24 **that rely (to one extent or another) on the use of local switching. Yet, when**  
25 **calculating the cost of the local switching *element*, the technician's salary is a direct**

1 cost and is included in TSLRIC.

2

3 Finally, there is a category of common costs -- the costs associated with product  
4 development, marketing, and advertising that support GTE's retail operations, as  
5 well as financial and managerial costs, that would be incurred whether GTE owned  
6 and managed its network or not -- that have no relevance to the costing of network  
7 elements because these costs are not incurred to provide network functions.

8 However, this does not mean that these costs will go unrecovered. It only means  
9 that GTE must be as efficient as its rivals, who must also recover these costs in the  
10 prices of their services.

11

12 *C. Transport and Termination*

13

14 **Q. WHAT IS "TRANSPORT AND TERMINATION"?**

15

16 **A.** Transport and termination is the network function used to complete a call on a  
17 network. It includes two components: the interoffice *transport* between wire  
18 centers in a network, and the *termination* through the end office switch to the  
19 customer's premise.

20

21 **Q. ARE ACCESS AND "TRANSPORT AND TERMINATION" IDENTICAL?**

22

23 **A.** Yes. The functionality to terminate a call is the same whether the call is classified  
24 as a "local" call or a "long distance" call. A pricing issue arises, however, because  
25 the charges to long distance carriers to terminate toll traffic (i.e., access) are far



1 above cost.

2

3 **Q. WHY ARE CALL TERMINATION PRICES SO IMPORTANT?**

4

5 A. The prerequisite to any form of telecommunications competition is the ability to  
6 complete calls to other subscribers, virtually all of whom (within GTE's exchanges)  
7 are served by GTE's network. In this regard, the introduction of local competition is  
8 not unique. Whether a call is labeled local or long distance, it still must be  
9 terminated to the customer.

10

11 **Q. WHY IS IT IMPORTANT THAT RATES FOR TRAFFIC TERMINATION**  
12 **BE THE SAME FOR "LOCAL" AND "LONG DISTANCE" TRAFFIC?**

13

14 A. One of the potential benefits of full service competition is competitively determined  
15 "local" calling areas. In a competitive market, the "local" calling area should  
16 become an important dimension of product differentiation, with carriers offering a  
17 variety of price and boundary packages to consumers.

18

19 For GTE to charge a different price for terminating "long distance" calls and "local"  
20 calls, GTE would need to require that all competitors adopt the same definition of  
21 local calling *and* GTE would need to implement auditing systems to correctly assess  
22 its charges. Such systems are not only unnecessary, but they would be used solely  
23 to accomplish an unreasonable result -- the continued discrimination between local  
24 and long distance calling, and to maintain the payment of access charges far above  
25 costs to the incumbent LEC.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

The preferable approach is to establish non-discriminatory termination rates that do not attempt to differentiate between types of calls. In this way, carriers would be free to decide the scope of their own local calling areas, sizing these areas to match their own perception of the market and to reflect their own pricing and marketing strategies. In this way, the market -- which is to say, *consumers* -- will decide the size and shape of the local calling area as carriers compete along this important dimension of service.

**Q. DOES GTE AGREE THAT INTERCONNECTION PRICES SHOULD BE NON-DISCRIMINATORY?**

A. Yes. In GTE's Comments to the FCC on these same issues (CC Docket No. 96-98, page 72), GTE recommends that:

... in a regulatory environment that compels unbundling and resale, discrimination based on the identity of the customer is generally untenable because there is no way to enforce such restrictions or prevent arbitrage.

Accordingly, state and federal regulators must rationalize pricing structures for all users of the ILEC's network.

Similarly, this Commission should implement a comprehensive cost-based pricing system which does not discriminate between types of calls or carriers. To the extent

1 that some portion of today's access rates are needed to subsidize particular  
2 consumers or services, then that subsidy should be specifically identified and  
3 explicitly recovered through a competitively neutral universal service fund.

4

5 **Q. IF TERMINATING LOCAL CALLS AND TERMINATING LONG**  
6 **DISTANCE CALLS ARE IDENTICAL, WHY SHOULDN'T THE**  
7 **COMMISSION APPLY ACCESS CHARGES TO LOCAL CALLS?**

8

9 **A.** The problem is that access charges are significantly inflated over cost. Using these  
10 inflated charges to establish charges for local termination would simply adopt a  
11 "poison both wells" pricing strategy. While the services might be equivalent, the  
12 consequences from the excessive rate levels would not be.

13

14 Long distance competition has survived despite high access prices for two reasons.  
15 First, incumbent LECs could not provide long distance services and, as a result,  
16 retail price levels reflected that all providers faced the same (albeit high) cost for  
17 this input. Second, long distance prices and access charges are both measured.  
18 Therefore, access costs and revenues both grow or diminish with traffic volumes.

19

20 Neither of these conditions holds true in the local exchange marketplace. Entrants  
21 will have to compete with GTE on day one, and GTE's cost to offer local service is  
22 the economic cost of network usage, not the access charge. Second, local exchange  
23 prices in Florida are flat-rated, and imposing on GTE's rivals a cost-structure  
24 directly at odds with retail rates will place them at a disadvantage when serving  
25 consumers with relatively high local calling patterns.

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

**Q. HOW SHOULD THE COMMISSION ESTABLISH LOCAL CALL TERMINATION RATES UNTIL IT IS ABLE TO CORRECTLY ESTABLISH ACCESS CHARGES?**

**A. The Commission should establish cost-based transport and termination rates for access and local traffic. In the interim, the Commission should rely on a bill and keep system. Until both access and local transport and termination rates are cost-based, mutual traffic exchange should be used as the interim basis for compensation.**

**V. OPERATIONAL BARRIERS TO ACHIEVING CUSTOMER CHOICE**

**Q. HOW DO OPERATIONAL ISSUES AFFECT CUSTOMERS AND THEIR ABILITY TO BENEFIT FROM LOCAL COMPETITION?**

**A. There are two ways that operational questions directly will impact consumer perceptions concerning local competition. In order for local competition to be viewed as a success:**

- it must be easy for *consumers* to change local carriers, at least as easy as the PIC-change process they are now familiar with, and**
- it must be easy for *carriers* to serve consumers quickly and with a minimum of network disruption.**

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

Only if these conditions are satisfied will the market changes contemplated by the Act roll out smoothly in the eyes of consumers.

*A. Supporting Customer Choice*

**Q. WHY IS IT IMPORTANT FOR OPERATING SYSTEMS TO BE ABLE TO EASILY ACCOMMODATE CONSUMER CHOICES?**

**A.** When the Act is fully implemented, today's familiar separation between local and long distance companies will be replaced with many consumers choosing a full service provider for both their local and long distance needs. A primary motivation for full service (i.e., one-stop shopping) competition will be convenience. This may seem obvious, but the benefits of full service competition cannot be realized if *moving* to a full service provider is inconvenient and disruptive.

With this in mind, it is useful to compare the relative ease and convenience that consumers would experience when choosing between GTE and any other full service provider, including their existing long distance carrier. This is the most relevant comparison, because these carriers today share the *same* customer base and thus are most likely to approach these customers with the goal of becoming their full service provider.

**Q. ARE THE EXISTING PROCESSES USED TO IMPLEMENT CONSUMER CHOICES AMONG LONG DISTANCE PROVIDERS AT ALL**

**COMPARABLE TO LOCAL SERVICES?**

1  
2  
3 A. No. The process used to transfer a customer to a new long distance company, the  
4 PIC-change process, is automated, inexpensive and sized to handle large demands.  
5 Significantly, it is also well tested, having been used for more than a decade,  
6 through countless product introductions, advertising campaigns, and marketing  
7 initiatives. In contrast, the "process" used to change local providers is unknown  
8 and, in any environment where a physical circuit rearrangement is necessary,  
9 inherently more complicated and problematic.

**Q. WHAT MUST OCCUR FOR COMPETITION TO SUCCEED?**

10  
11  
12  
13 A. Consumers must be able to move between local service providers with the same  
14 ease that they now move between long distance carriers. This is necessary both for  
15 consumers to perceive this market change as beneficial and to assure that both local  
16 and long distance carriers have a fair opportunity to become the consumer's full  
17 service provider.

18  
19 Second, however, a PIC-like customer migration process must be available both for  
20 local services resale *and* the unbundled network element approaches. Without the  
21 ability to honor customer changes inexpensively, the network element option could  
22 only be used to serve selected customers and the advantages of this option would be  
23 limited to the few.

***B. Ordering Combinations of Unbundled Network Elements***

1

2 **Q. HOW CAN UNBUNDLED NETWORK ELEMENTS BE USED TO PROVIDE**  
3 **LOCAL SERVICES WITH THE LEAST DISRUPTION TO CONSUMERS?**

4

5 A. In order for consumers to benefit from competition, carriers must be able to easily  
6 obtain and configure the unbundled network elements that they will use to provide  
7 services. The key to rapid competition and easy customer choice is the ability of  
8 entrants to provide service using unbundled local switching, frequently in  
9 combination with other elements. With unbundled local switching, customers can  
10 be moved between different providers without physically reconfiguring the service  
11 to the customer.

12

13 **Q. CAN THE UNBUNDLED LOOP, BY ITSELF, PROVIDE THIS**  
14 **FLEXIBILITY?**

15

16 A. No. Unbundled loops, while important, are unlikely to support broad-scale, mass-  
17 application, entry into the local services market.

18

19 First, the unbundled-loop configuration is viable only where a collocated network  
20 exists. Even where these networks are economically attractive, they now do not  
21 exist and it will take time for them to be constructed and made operational.

22

23 Second, and more permanently, the unbundled-loop configuration easily cannot  
24 effect large changes in market share between alternative providers because physical  
25 changes in the network will be necessary -- i.e., the actual loop to the customer must

1 be reconfigured from GTE's local switch to a competitor's every time a customer  
2 changes a local service provider.

3  
4 As a result, unbundled loops (by themselves) are unlikely to foster a fully  
5 competitive environment. Instead, carriers will need to order combinations of  
6 network elements, typically involving unbundled local switching, to provide  
7 competitive services to consumers.

8

9 **Q. HOW WILL CARRIERS BE ABLE TO MOVE CUSTOMERS MORE**  
10 **RAPIDLY USING UNBUNDLED LOCAL SWITCHING?**

11

12 A. The answer is using the network to move customers without manual changes in the  
13 physical connections to these customers. This condition is satisfied by a network  
14 configuration which combines several network elements, including local switching,  
15 to provide service. Customers can easily change among local carriers who are  
16 providing services using the incumbent LEC's unbundled local switching element,  
17 because the customer's lines need not be reconfigured to a different switch for  
18 service. This arrangement is sometimes referred to as the "platform" configuration.

19

20 **Q. WHAT IS THE "PLATFORM" CONFIGURATION?**

21

22 A. The platform configuration is the combined purchase of unbundled switching and an  
23 unbundled loop (frequently in combination with transport, termination and  
24 signaling) to form a basic exchange platform to offer local exchange and exchange  
25 access services. The critical element is correctly defining unbundled local switching



1 to enable the new entrant to: (a) activate (more precisely, to *order* that the  
2 incumbent LEC activate) the various features on the customer's loop that defines its  
3 local services, (b) define traffic routing as alternative networks become available  
4 (although, initially, it is likely that local traffic would be terminated using the  
5 incumbent LEC's network), and (c) create the records to bill the end-user for local  
6 exchange service and other carriers for exchange access and interconnection service.  
7 By providing services using a combination of unbundled loops and switching,  
8 several of the operational barriers presented by utilizing unbundled loops alone can  
9 be overcome. Again, the basic definition of unbundled local switching is provided  
10 in more detail in the testimony of AT&T Witness Ray Crafton.

11

12 **Q. HOW DOES THIS CONFIGURATION OVERCOME THE LIMITATIONS**  
13 **ASSOCIATED WITH THE UNBUNDLED LOOP ELEMENT DESCRIBED**  
14 **EARLIER?**

15

16 **A.** First, the platform configuration efficiently uses the existing network to obtain  
17 switching and call termination. As a result, its value is not artificially limited to  
18 central offices where a carrier has established a collocated network node, nor does it  
19 require a duplication of GTE's preexisting interoffice and local switching matrix as a  
20 prerequisite to entry.

21

22 Second, customers can easily shift between local providers using the platform  
23 configuration because the existing exchange line does not need to be reconfigured to  
24 provide service. Because the underlying facility arrangement is unaffected,  
25 operational systems should be able to accommodate market changes with an ease

1 comparable to the PIC-change process used in the long distance industry.

2

3 Third, one of the benefits of the platform configuration is that it solves (at least  
4 temporarily) the entry barrier presented by the absence of number portability.

5 Because the new entrant's customers would continue to be served by the incumbent's  
6 local switch, there is no need for consumers to change phone numbers as they move  
7 between local providers.

8

9 **Q. ARE THERE OTHER BENEFITS FROM THIS ARRANGEMENT?**

10

11 **A.** Yes. The platform approach provides every carrier an ability to design its own  
12 services, constrained only by its own imagination and the inherent ability of the  
13 network. Unbundled local switching enables a carrier to purchase switching  
14 capacity as a generic ingredient and then determine which features and capabilities  
15 of the switch it will offer as part of its finished local services. The advantages of  
16 this approach will become even more pronounced as the "Advanced Intelligent  
17 Network" ("AIN") call processing model is introduced.

18

19 AIN uses a system of "triggers" to access remote databases for call processing  
20 instruction. For instance, the "off-hook trigger" automatically suspends call  
21 processing at the switch when the customer lifts its receiver. The trigger then  
22 queries a service control database for additional instructions. One way of looking at  
23 AIN is that it takes the *intelligence* out of the network switch, and uses the switch  
24 simply to execute call processing. In an AIN environment, each entrant should be  
25 able to define unique new services for their particular customers, even if they all use

1 the same local switch to provide dial-tone and provide the first point of switching.

2

3 In addition, the platform configuration allows each carrier the flexibility to provide  
4 its own local exchange services to end-user customers, and exchange access services  
5 to other carriers, achieving the same status and opportunities as any other local  
6 telephone provider. Competition across all prices and services would then be  
7 possible.

8

9 Of course, as noted at the beginning of this Section, none of these benefits are  
10 possible unless consumers are able to easily implement a choice in carriers. That is  
11 why it is so important to implement the operating systems that are described further  
12 in the testimony of AT&T Witness Jim Carroll.

13

#### 14 **VI. SUMMARY**

15

16 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

17

18 **A. The Commission's decision in this proceeding may be the most significant in its  
19 history as a regulator of telecommunication services. The Act has the potential of  
20 bringing substantial competitive benefits to Florida consumers, providing them, for  
21 the first time, direct say in the services they are offered through the power of choice.  
22 Realizing these benefits, however, can occur only if the entry tools described in the  
23 Act become practical, working vehicles that entrants may use to provide that choice.**

24

25 **This, in a sentence, is the fundamental objective of this arbitration -- to provide**

1 AT&T (and other entrants) the tools they will need to provide local exchange  
2 services in competition with GTE. Creating these tools quickly has particular  
3 importance here because GTE has already crossed the line to full service provider  
4 without having to first provide others an ability to compete.

5  
6 What do entrants need? Simply this: the ability to resell wholesale equivalents of  
7 GTE's retail services at wholesale rates; the ability to purchase and combine a core  
8 list of unbundled network elements, correctly priced at economic cost; and the  
9 ability to terminate traffic at cost-based, reciprocally applied, charges. Each  
10 supported by an operational infrastructure designed for a multi-vendor local  
11 marketplace. This is what the Act provides for, this is what the entrant is entitled to,  
12 and this is what the Commission must see gets implemented.

13  
14 Why? First and most obviously, to give consumers choice. But also, because GTE  
15 has already entered the long distance market.. There, GTE found wholesale long  
16 distance services and network elements at competitive prices. There, GTE found an  
17 operational infrastructure specifically designed to support a multi-vendor market,  
18 including systems to easily implement customer choices. In short, GTE found the  
19 long distance equivalent to all that the Act requires that GTE offer others.

20  
21 The Commission has long recognized its role as a surrogate for competition.  
22 Historically, this role has been limited to the retail market. However, under the Act,  
23 the Commission's role as a competitive surrogate shifts to the wholesale level,  
24 because it is there that GTE's network monopoly poses the greatest risk. The  
25 Commission's role now includes making this network available so that multiple

1 carriers may use it to offer retail services to consumers.

2

3 It is this final linkage to consumer prices that the Commission should not lose sight  
4 of as it approaches the issues in this arbitration. Establishing the correct carrier-to-  
5 carrier arrangements is complex, but, again, the ultimate beneficiaries will be  
6 Florida consumers.

7

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

9

10 **A. Yes.**

1           Q           (By Ms. Dunson) Mr. Gillan, did you  
2 prepare a summary of your testimony?

3           A           I did.

4           Q           Would you please give it for the record?

5           A           Yes. Good morning, Commissioners and  
6 welcome again to Round 2, I suppose. There's a very  
7 famous expression that basically goes: Those who are  
8 unfamiliar with history are condemned to repeat it. I  
9 think that that saying has a lot of merit in the  
10 context of GTE. Because if you are interested in what  
11 the future could look like if your actions here are  
12 done incorrectly, you can find it today in GTE's  
13 territory.

14                       I say that because GTE obtained preferential  
15 treatment under the Telecommunications Act. They were  
16 essentially permitted to move themselves into the mold  
17 of a full service provider that can offer local and  
18 long distance services as a package without having to  
19 first take any of the steps necessary to permit any  
20 other carrier to compete in a similar way.

21                       How are they able to do that? Well, once  
22 the Act removed any legal restriction on GTE, it was  
23 able to go into the long distance marketplace and do  
24 all the steps necessary to enter that business  
25 effectively within one hour of the Act signing.

1           They were able to obtain the long distance  
2 equivalent to network elements. They could buy  
3 capacity and switching in that market. They were able  
4 to do so in an environment where the rate relationship  
5 between retail revenues and network costs reflects  
6 approximately a 75% to 85% discount. That's the  
7 spread between revenues and costs, network costs, in  
8 the interexchange market.

9           They were able to do so under conditions  
10 that enabled them to brand their services, brand their  
11 operator services, brand their directory services.  
12 They were able to do so under arrangements that  
13 allowed them to selectively route different categories  
14 of traffic: international, operator, directory  
15 assistance. They were able to do it by adding  
16 customers through electronic interfaces, including the  
17 ultimate electronic interface, the PIC change process,  
18 that makes it inexpensive and simple for customers to  
19 move between long distance providers.

20           Why were those tools available to them?  
21 Effectively, because 10 years ago this nation made the  
22 commitment to long distance competition. And in part,  
23 as a result of strong governmental actions, those  
24 tools became available so that GTE can take advantage  
25 of them today.

1           How are they doing? Well, despite their  
2 concerns and their gloom and doom predictions, GTE is  
3 doing quite well. They are, in effect, proving that  
4 at least one of the hypotheses underlying  
5 congressional legislation was true, that a substantial  
6 portion of the market would like to obtain local and  
7 long distance service together. So far, they are  
8 running ahead of budget adding, at last release, 9,000  
9 customers a day. Their projection is to obtain 20% of  
10 the market within two years. Effectively  
11 accomplishing in two years, what it took MCI two  
12 decades to achieve.

13           They are projecting earnings per share  
14 growth of 10% per year for the foreseeable future. In  
15 short, as Merrill Lynch put it, how often is that an  
16 industry, GTE, can wake up one day, find that its  
17 revenues, its addressable market, have been expanded  
18 by 40% and that they can expand into that market long  
19 distance with negligible start-up costs.

20           Why are they so successful? Well, they are  
21 so successful because they, and they alone, are able  
22 to participate as a full service provider, showing  
23 actually one of the other concerns that underlie this  
24 legislation is also true, that in an environment where  
25 customers choose a local and long distance carrier



1 together, the fate of all competition depends on local  
2 competition succeeding.

3           If GTE is the only carrier able to offer  
4 these packages, then effectively long distance  
5 competition will collapse to the point that it mirrors  
6 local competition, which is why it is so important for  
7 local competition to succeed. Congress did not intend  
8 for the Bell system to be recreated. Rather they  
9 intended for multiple carriers to have an opportunity  
10 to provide local exchange service. And to do so, they  
11 created the tools that this Commission is now being  
12 asked to order GTE to provide into the marketplace,  
13 the full mosaic of entry that we talked about last  
14 week, so that carriers can offer these services  
15 broadly in GTE's region; they can do it rapidly; and  
16 they can do it on an economic basis comparable to GTE.  
17 This means that the network elements have to be priced  
18 correctly and that carriers have the clear opportunity  
19 to order and use combinations of network elements.

20           The combination of loop and switching is  
21 probably the single most important competitive vehicle  
22 that entrants will have. That combination enables  
23 customers to move between local providers with an ease  
24 comparable to their choice in long distance. It  
25 enables carriers to rapidly approach the market. Not

1 just in downtown Tampa, and not just for large  
2 businesses, but broadly throughout the region. It  
3 enables carriers to design their own local exchange  
4 services, and it enables them to do all of this on an  
5 economic basis comparable to GTE by being a provider  
6 of both the local exchange and exchange access  
7 service. This in turn means that local rates need not  
8 increase, that carriers can enter this market, compete  
9 with GTE and recover those costs across the same range  
10 of service that GTE does.

11 In short, I encourage you to fully implement  
12 the statute, to effectively restore the balance that  
13 congress envisioned for the Bell operating regions  
14 where local competition has to be established, so that  
15 full service competition can continue. Thank you.

16 Q Does that conclude your summary?

17 A Yes.

18 MS. DUNSON: The witness is available for  
19 cross examination.

20 CHAIRMAN CLARK: Mr. Melson.

21 MR. MELSON: No questions.

22 CHAIRMAN CLARK: Mr. Gillman. Mr. Fuhr.

23 MR. FUHR: Yes, GTE has a few questions.

24

25

## CROSS EXAMINATION

1  
2  
3  
4  
5  
6  
7  
8  
9  
10  
11  
12  
13  
14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25

BY MR. FUHR:

Q Mr. Gillan, do you have a copy of your testimony in front of you?

A Yes.

Q Would you turn to Page 3 of your testimony, Line 19. You state there that GTE has leapfrogged the natural sequence of competitive entry. Do you see that?

A Yes.

Q And that relates in part to your criticisms of the Telecommunications Act that are contained throughout your testimony and as well as your summary that you believe gave GTE a preferred position in the market; is that correct?

A Yes.

Q And that's a criticism you have of the Telecommunications Act of 1996, correct?

A Yes.

Q You have your phrase there, "the natural sequence of competitive entry." Can you tell me where that phrase is defined in the economic literature?

A Nowhere.

Q Is that your own personal phrase?

A Yes.

1           Q     Is there any other source of authority for  
2 what you call "the natural sequence of competitive  
3 entry"?

4           A     No.

5           Q     It is only the sequence of competitive entry  
6 that is natural to you?

7           A     No. I think that the statement speaks for  
8 itself. GTE adding long distance was a no-brainer.  
9 It has happened thousands of times since divestiture.  
10 This country has already gone through to create  
11 everything necessary for a company to easily enter the  
12 long distance portion of this market.

13                     In order for there to be a competitive  
14 alternative to GTE in the full service market, it must  
15 become as easy to offer local exchange service. Since  
16 that hasn't occurred anywhere in this country to date,  
17 I believe it's a much more natural sequence of entry  
18 to first create the conditions necessary for the  
19 unknown, the event that has never occurred.

20                     Local competition then, once you know the  
21 carriers can offer local competitively, allow the  
22 local company to offer long distance competitively.  
23 That's what I mean by the natural sequence of entry.

24           Q     And that's the heart of your beef with what  
25 congress did, correct?

1           A     It's not actually a beef -- no, it's not  
2 actually a beef with what congress did. I recognize  
3 that congress -- that the Telecommunications Act of  
4 1996 was a political instrument. Therefore, political  
5 compromises were achieved. As a policy instrument, I  
6 think it sets in place a very significant problem in  
7 GTE's market.

8                     You are out there effectively distorting  
9 long distance competition by maintaining your monopoly  
10 on local service. And this action the Commission  
11 needs to take aggressively the steps that the Act  
12 requires you to take to implement those aggressively,  
13 to correct that imbalance.

14           Q     Again, the political judgment and the  
15 politics that you referred to is also the law of the  
16 land, correct?

17           A     Yes. But the law of the land is now for you  
18 to live up to your side of the bargain and to take the  
19 steps needed so that others may offer local service in  
20 competition with you.

21           Q     Okay. Mr. Gillan, would you turn to Page 15  
22 of your testimony? And looking at your answer  
23 beginning on Line 18, you describe there GTE's  
24 management expectations that will gain 10% of the  
25 market in 12 short months. I gather you've also now

1 clarified that with the 20% reference in your summary  
2 that you gave. Do you see that testimony there?

3 A Yes.

4 Q Isn't it fair that the Telecommunications  
5 Act of 1996 has given a lot of companies the  
6 opportunity to either get into substantial new markets  
7 that heretofore they were not able to get into?

8 A In theory, it did that. In practice, it did  
9 so far less because the implementation needs to be  
10 accomplished.

11 Q Well, you wouldn't disagree that AT&T was  
12 one of the companies that was given that substantial  
13 opportunity as well, would you?

14 A No. I would not disagree they were given  
15 the opportunity, but that opportunity is completely  
16 hollow until these proceedings are concluded and GTE  
17 not only accepts them and abides by them, but  
18 implements the things that are directed. And that's a  
19 fundamental difference. Everything GTE needed, it got  
20 immediately. It entered the long distance business  
21 within an hour.

22 Here we are eight months since the Act's  
23 passage, and AT&T is -- nor is anyone else any closer  
24 effectively to enter the local market than they were  
25 on February 8th.

1           Q     I'm not sure whether that's a criticism of  
2 GTE or this Commission or the commissions in terms of  
3 when they are scheduling their hearings, but the Act  
4 itself set up a fairly rigid timetable for all these  
5 Commissions and all these parties to pull all this  
6 material together; did it not?

7           A     Yes.

8           Q     And I haven't seen any evidence. Have you  
9 seen any evidence of any of the parties trying to slow  
10 down that process in terms of when these hearings are  
11 being scheduled? I mean, you are complaining it's  
12 been nine months since we've had these hearings, but  
13 that was all set out by the Act; was it not?

14          A     Yes, it is true it was set out by the Act.  
15 But my testimony -- and the testimony isn't criticism  
16 of GTE per se. You are acting in your own narrow  
17 business interests --

18          Q     And so is AT&T --

19          A     -- the reality is --

20                CHAIRMAN CLARK: One at a time.

21                WITNESS GILLAN: The reality is that the Act  
22 could make it easy for GTE to enter the long distance  
23 business; it's going to take strong government action  
24 to make it possible for people to enter the local  
25 business.

1           Q           (By Mr. Fuhr) And you do not deny, do you,  
2 that AT&T is acting in its narrow self-interest also,  
3 do you?

4           A           No. I do believe, however, that in this  
5 case AT&T's self-interest and the public interest are  
6 in alignment because it goes to providing customers  
7 with a choice of someone other than GTE.

8           Q           And just as AT&T's interests are narrow and  
9 self-serving, your testimony here on their behalf is  
10 simply to further that ambition of theirs; is it not?

11          A           No, that wasn't my testimony. I indicated  
12 that yes, AT&T in seeking to -- to really get what it  
13 is entitled to under the Act is pursuing its interest.  
14 However, the tools that you create today aren't going  
15 to be used simply by AT&T. They're going to be used  
16 by all entrants. So what the Commission is  
17 effectively doing is creating the opportunity for  
18 carriers to serve customers with the goal being that  
19 those customers then have choice.

20                    It is true that it's in AT&T's best interest  
21 to encourage you to do it, but it's in the public  
22 interest that you do it. Because every day that goes  
23 by that those customers don't have choice, GTE is  
24 going to both be able to distort long distance  
25 competition by exploiting the fact that it retains a



1 local monopoly, and those customers in GTE territory  
2 will not have choice.

3 Q Mr. Gillan, isn't it true that AT&T's  
4 business plan in these Commission hearings, or part of  
5 that business plan, is to obtain easy early access to  
6 these markets without any major investment?

7 A No, I think that that's a gross and  
8 inaccurate oversimplification.

9 Q Why don't you explain why that is a gross  
10 inadequate simplification.

11 A The imagery that somehow AT&T's efforts in  
12 this proceeding, and AT&T's -- in fact, any carrier's  
13 efforts to enter the local market doesn't require  
14 substantial investment ignores the fact that the local  
15 market is a fundamentally more complicated environment  
16 to participate in than the long distance market.

17 Even if one were to approach this market and  
18 become a choice by obtaining and using network  
19 elements from GTE, the process of completely changing  
20 your company to be able to operate at that level  
21 designing local products, supporting those customers,  
22 handling those calling volumess, addressing those  
23 customer-specific issues are very, very significant.

24 Secondly, I'm not aware of hardly any  
25 carriers that aren't looking at obtaining network

1 elements from GTE and the incumbent as the end result.  
2 It is all part of a process to begin that network  
3 development. But even with those intentions, the  
4 Commission should neither expect that duplicative  
5 local networks could ever materialize overnight, that  
6 they are going to materialize everywhere, or finally  
7 that it's in this Commission's or the public's best  
8 interest to expect of people that they make investment  
9 in local networks before they are able to offer  
10 service. There's some 300 long distance carriers  
11 today but there are four networks. Why are there 300  
12 long distance carriers? Because they specialize in  
13 different parts of the market and they offer different  
14 things.

15           The network itself, switching and  
16 transmission, is a commodity. How they differentiate  
17 themselves is along a number of other dimensions.

18           GTE itself has entered the long distance  
19 market without making any significant capital  
20 expenditure to do so. Yet GTE is enormously  
21 successful. Why? In part because they are giving  
22 customers something they want: Local and long  
23 distance service as a package. My testimony goes to  
24 that, the Commission needs to make sure that other  
25 people can give customers what they want as well.

1           Q     Is it your view then that the  
2 characterization that AT&T is pursuing easy early  
3 access without major investment is a deceptive  
4 characterization of what AT&T is doing?

5           A     I don't believe I called you deceptive. I  
6 thought I told you it was just oversimplification.

7           Q     I don't take it personally. I'm just asking  
8 what you think the statement is deceptive.

9           CHAIRMAN CLARK: Mr. Fuhr, we usually let  
10 the witness answer and then you can ask another  
11 question.

12           MR. FUHR: I'm sorry. I apologize.

13           CHAIRMAN CLARK: Go ahead, Mr. Gillan.

14           A     I believe the answer was no, because I was  
15 concerned about the implication of the word  
16 "deceptive". I thought it was an oversimplification  
17 and an error.

18           Q     Have you discussed your testimony with  
19 Richard Miller, chief financial officer of AT&T?

20           A     No.

21           Q     Are you aware of his statement in the  
22 September 30 "Telecommunications Reporter" in which he  
23 was quoted as saying, quote, "Looking to the future  
24 AT&T is currently putting together its 1997 and beyond  
25 business plan together. AT&T's local service strategy

1 will be a new element of the plan because of the new  
2 FCC rules. It's easy early access without major  
3 investment so we can get a head start on our  
4 competitors." Have you looked at that statement  
5 before?

6 A No.

7 Q But that's an oversimplification?

8 A I believe that that's an oversimplification  
9 of AT&T's overall objective, yes. Even if it comes  
10 from him.

11 Q Mr. Gillan, would you turn to Page 22 of  
12 your testimony. And would you look at Lines 5  
13 through -- I think the sentence begins on Line 4 goes  
14 through Line 7, and the question that led into that  
15 was "How will the prices that GTE charges carriers for  
16 unbundled network element interconnection and  
17 transport and termination on its network influence  
18 retail rates?" And that's the question that appears  
19 at the bottom of Page 21. Do you have that front of  
20 you?

21 A Yes.

22 Q And calling your attention again to the  
23 sentence that begins with the phrase "With correctly  
24 priced carrier network charges" and that begins on  
25 Line 4 of Page 22. Do you have that in front of you?

1           **A**     Yes.

2           **Q**     Does this include -- does this include a  
3 suggestion that the new entrants will be able to  
4 resell -- that AT&T will be able to engage in resale  
5 at below cost?

6           **A**     No. This statement goes only to the ability  
7 to buy network elements.

8           **Q**     But if they are able to buy those network  
9 elements from GTE below cost, they would be able to  
10 resell them at below cost, would they not?

11          **A**     Yes. That statement is true, but that's not  
12 what the sentence says.

13          **Q**     And if AT&T is able to buy or interconnect  
14 below cost, what effect does that have on the  
15 development, further development of a network by AT&T,  
16 or any competitor for that matter?

17          **A**     It would discourage it. But again, I'm not  
18 recommending that the Commission establish network  
19 element or interconnection prices below cost.

20          **Q**     You have laid out in your testimony some of  
21 the negative consequences that would occur if at the  
22 other extreme this Commission set prices that were too  
23 high, and that's clearly what you think GTE is  
24 attempting to do, am I right?

25          **A**     Yes.

1           Q     There is also -- let me backtrack there.  
2     And if this Commission set pries that were too high,  
3     you are concerned that it would allow unjust  
4     enrichment to GTE. Am I right so far?

5           A     Yes.

6           Q     It would hurt the consumers. Again am I  
7     right?

8           A     Yes.

9           Q     Three, it would hurt AT&T, MCI, and others  
10    who want to come into this new market, correct?

11          A     Yes.

12          Q     And presumably there are investors in those  
13    programs as well?

14          A     Yes. And it would damage the markets that  
15    they participate in today because you have entered  
16    them.

17          Q     And, in general, resource allocation,  
18    efficient competition would be frustrated by setting  
19    the prices too high, correct?

20          A     Yes.

21          Q     And that's, in fact, a summary of not all of  
22    your testimony but at least a portion of your  
23    testimony, right?

24          A     This page, yes.

25          Q     There are similar consequences, if not

1 identical consequences, if this Commission were to set  
2 the prices below GTE's cost, is there not?

3 A So long as we agree on what that phrase  
4 means, yes.

5 Q The phrase you're talking about is the  
6 phrase "below cost"?

7 A Correct. Actually I was thinking of only  
8 the word "cost." I think we could agree on the word  
9 "below."

10 Q It's the same phraseology concern that we  
11 would have with respect to setting the prices above  
12 cost?

13 A Correct.

14 Q The definition of cost is the same either  
15 way and we may disagree as to what that is but once  
16 you get a meaningful definition of cost, that is a  
17 proper definition of cost, you, I think, have the  
18 phrase "economic cost" in your paper, do you not?

19 A Yes, but that was only to the phrase that's  
20 economic cost -- I'm sort of lost if there's a  
21 question here.

22 Q My question is if prices are set below GTE's  
23 economic cost, there are a parade of horrible  
24 consequences that come from that decision as well, is  
25 there not?

1           **A**     There would be consequences from it, yes. I  
2 don't know that they would be the same or even the  
3 mirror image of the other consequences.

4           **Q**     Let's look at what those consequences might  
5 be.

6                     Given your background in economics, I guess  
7 you have an undergraduate degree, masters degree in  
8 economics, what in your professional opinion would be  
9 the consequences to GTE if it were required to sell  
10 its elements and provide services to AT&T below its  
11 economic cost?

12           **A**     It would lose customers to AT&T and not be  
13 compensated correctly for the use of those elements.

14           **Q**     What would it do to GTE's ability to attract  
15 capital?

16           **A**     It would be diminished.

17           **Q**     What would it do to the allocation of  
18 resources within the industry?

19           **A**     Alternative networks would be deployed more  
20 gradually and to a lesser extent. GTE's network would  
21 be overutilized.

22           **Q**     And when you say "overutilized" etcetera,  
23 you're talking about it would not be the most  
24 efficient allocation in development of a network, am I  
25 right?



1           **A**     Correct.

2           **Q**     What would be the cost to the consumers of  
3 the state of Florida if this decision set a rate that  
4 was below GTE's economic cost?

5           **A**     Well, the direct impact is that they would  
6 probably benefit.

7           **Q**     Over the long run?

8           **A**     That's a much more difficult question. But  
9 certainly in the short run they would pay less for  
10 phone service, less than they actually should, but  
11 they would pay less. So it's one of those situations  
12 where "your harm, their gain." I'm not advocating it  
13 but it's not clear to me that they would be harmed  
14 except over a long-term horizon.

15          **Q**     And that long run horizon is, in fact, the  
16 horizon that the Federal Act, the Telecommunications  
17 Act, requires that this Commission and all of the  
18 parties pursue; is that correct?

19          **A**     Yes, I think that's correct.

20                   **COMMISSIONER JOHNSON:** Let me stop you just  
21 one minute. I don't want to stop your train of  
22 thought, but why would the consumers be paid less?  
23 You said that in an absolute sense.

24                   **WITNESS GILLAN:** If GTE is making its  
25 network available to competitors at below cost rates,

1 since multiple carriers will have the opportunity to  
2 buy this network at that rate, competition would drive  
3 the prices that retail customers pay down to reflect  
4 the -- not down to, but at least down to reflect the  
5 underlying cost of the network.

6           So if you hold -- as you bring the network  
7 cost down, retail prices should follow because there  
8 will be competition at the retail level. That's why I  
9 was saying that I expected local -- retail rates would  
10 fall to reflect the fact that the network was being  
11 priced so low.

12           Now, it would be an artificial price  
13 reduction because in his hypothetical where you are  
14 now doing this below economic cost, but that would  
15 probably be the consequence.

16           **COMMISSIONER JOHNSON:** What would happen to  
17 other facilities-based providers if we were to set  
18 the -- if the cost was too low, if the prices were set  
19 below cost?

20           **WITNESS GILLAN:** In theory, if you could  
21 produce a network, create a network at a lower cost  
22 than GTE, you might be discouraged from doing it  
23 because you could obtain portions of that network from  
24 GTE at a cost that was lower than GTE's economic cost.  
25 So that it would have that effect.

1           **COMMISSIONER JOHNSON:** Why do you say in  
2 theory? Do you think that would happen in fact, or --

3           **WITNESS GILLAN:** I said in theory because  
4 there's sort of a technical tension here.

5           If I'm going to develop a new network, the  
6 thing the Commission has to understand is that network  
7 deployment at the local level is a lot different, a  
8 whole lot different than what we've ever seen in the  
9 long distance network in terms of complexity,  
10 magnitude, size, scope -- everything about it. So at  
11 least in the short run -- and in this case I'll define  
12 the short run as being like the next five to ten  
13 years -- I would expect that networks will be deployed  
14 largely to large commercial premises concentrations of  
15 traffic just because of the fact that this is such a  
16 capital intensive business, and it's going to take so  
17 long to do this, you're obviously going to start at  
18 one part of the spectrum and work your way down.

19           The reason I said theory is while GTE makes  
20 its network available below cost, in my mind what I'm  
21 envisioning is some sort of rate throughout its region  
22 that might not bear the correct relationship to cost.  
23 But I would be surprised if it also meant that network  
24 construction to specific businesses, you know, that  
25 would fundamentally affect the economics of that

1 decision.

2           So the short answer is that because of the  
3 factors that are going to drive network construction  
4 in the near term are going to be so locationally  
5 specific that I don't think this problem would have  
6 that large a impact on those decisions and the front  
7 end of it. As you move further out in time the  
8 problem could become more significant.

9           **COMMISSIONER JOHNSON:** So as it relates to  
10 facilities-based competition or promoting  
11 facilities-based competition, somehow, some way to the  
12 residents, what you're saying is you don't think it's  
13 going to develop first there anyway and that the  
14 competition would be to large users and to more of the  
15 commercial business type customers. And that's where,  
16 perhaps, policies -- or there could be policies that  
17 could either promote or incentivize people to actually  
18 provide facilities-based competition in those areas?  
19 Or maybe I missed something. I guess I'm taking off  
20 the one hat and I'm thinking more of the residential  
21 users.

22           The facilities-based competition, will it  
23 occur there and should that be a policy that we should  
24 be thinking about and encouraging in any way?

25           **WITNESS GILLAN:** Facilities-based

1 competition for residential customers is going to be a  
2 tough nut to crack. There's a lot of things that are  
3 going to have to be worked out.

4 First of all, obviously with the  
5 announcements of the last few days, the announcements  
6 which, quite frankly, I'm not surprised that there's a  
7 lot less enthusiasm by the cable television industry  
8 to try and leverage phone service off their cable  
9 network.

10 There are a lot of reasons for that, not the  
11 least of which is the fact that there are have been  
12 technological problems with that approach that they  
13 just haven't really successfully overcome yet; at  
14 least on a wide scale basis.

15 If you take away the idea that you're going  
16 to be able to provide phone service off the existing  
17 network, you're really left with two alternatives:  
18 either develop a network or you use the existing one.  
19 Developing an network; what is that going to look  
20 like?

21 At present, there still isn't really  
22 identified for anybody a network platform that you can  
23 go ~~out~~ and construct that gives you the kind of  
24 ubiquity that you expect to go to the residential  
25 home. Wireless maybe. We don't know. Second wire

1 line network? It's looking kind of tentative. So now  
2 we back up.

3           There was at one point in this industry a  
4 lot of attention on the idea that if I put in a switch  
5 I can go by these loops and that's how I'll provide  
6 service. And an awful lot of the early regulatory,  
7 and even some of the Congressional debate focused on  
8 that, but even that sort of scenario has some  
9 limitations to it.

10           Every time a customer wants to change a  
11 phone company, they have to be physically disconnected  
12 and reconnected to the network. Where we have  
13 experience with that kind of practice, like in New  
14 York and Illinois, where they have been a little bit  
15 further along in this, it's been discovered that  
16 that's time consuming; there are costs associated with  
17 it. And what it means is unless you have a customer  
18 that has a lot of traffic to make it worth your while,  
19 and I expect that they are willing to make a term  
20 commitment to you so that you can amortize those  
21 nonrecurring costs over some portion of the  
22 relationship, that becomes a problem, fully aside from  
23 those technical problems.

24           So then you discover going down that path  
25 that in the residential market it's not likely to

1 prove enough to go out and serve these customers.  
2 That's realistically where the idea of buying loops  
3 and switching in a set combination came from.  
4 Carriers desires to take competition beyond the  
5 business district to the next level of consumer and  
6 why you would need to do that. Which is effectively  
7 why that language shows up in the conference report  
8 and in the ultimate Act itself about the ability to  
9 combine these elements.

10 So it's realistically -- this marketplace  
11 is going to develop a lot more slowly than long  
12 distance competition did from a facilities basis.  
13 It's almost off the scale in comparison of the dollars  
14 invested, the complexity, and the types of distributed  
15 network architecture you need to serve these people.  
16 Nobody, not AT&T, not anybody has the ability to do  
17 this in 50 states, in 5,000 cities or whatever.

18 It's going to happen. It's going to happen  
19 in cities first. It's going to spread out. But  
20 there's going to have to be reliance on the incumbent  
21 network for other people to provide customers choice.  
22 That was probably a very long answer but I thought you  
23 had a lot in your question.

24 COMMISSIONER JOHNSON: I appreciate the  
25 answer. I guess you had mentioned at one point what

1 is happening with respect to the cable companies, and,  
2 perhaps, at one point in time, perhaps even now, folks  
3 are looking to them as a second line provider of the  
4 real facilities-based provider.

5           Is that something that we should be  
6 concerned -- I'm going to stop so he can get through  
7 his questions and maybe ask you later -- but is that  
8 something that we should be concerned about as we  
9 develop policies, what we could do to provide the  
10 necessary incentives, that we do have facilities --  
11 other facilities-based providers so we can bring those  
12 technological advances that we have promoted through  
13 both the state and federal Act of all of the wonderful  
14 things to come when we open up these markets, or  
15 should we rely more on the resale kind of policies?

16           **WITNESS GILLAN:** I'm going to distinguish  
17 resale from buying network elements. Because I think  
18 buying network elements, even when you buy all of them  
19 is fundamentally a different environment.

20           **COMMISSIONER JOHNSON:** That's true.

21           **WITNESS GILLAN:** I think the Act takes all  
22 of the steps when it is implemented, when it's fully  
23 implemented, so that the opportunity there to make  
24 these network investments are correct.

25           There's not really much the Commission can



1 do about the fact that colored TVs put interference on  
2 a cable system; that that limits their attractiveness.  
3 That people haven't really developed the set-top boxes  
4 in a mass production mode that enables that technology  
5 to convert easily.

6 I guess my comments really go to you've got  
7 to expect this to be slower than even Congress, I  
8 think, was hoping when they first passed the bill.

9 Secondly, and to me this is even more  
10 important, I don't think you ever want it to be a case  
11 that in order to provide telecommunications services  
12 you have to first pass a litmus test of having a local  
13 network.

14 Most people, I think, want to buy their  
15 services from a single provider -- single vendor. If  
16 that's true and you permit network ownership to become  
17 a litmus test, you'll have as many vendors in the  
18 market as you have local networks, which no matter  
19 whose projections you take, it's likely to be very,  
20 very few.

21 So I think as a public policy the Commission  
22 should, and Congressional legislation certainly is,  
23 based on the notion that networks need to be open so  
24 other providers can offer services. You don't ever  
25 want to see this industry reconcentrate back to the

1 idea that if you don't control the link to the  
2 customer, you can't offer the customer a service.  
3 That's not in the customer's best interest. That's in  
4 competition's best interest. But admittedly it's  
5 going to always be in the best interest of whoever  
6 controls that link.

7 So I think the keys in the legislation, make  
8 the networks available, make sure access -- to use  
9 Mr. Milner's, or whatever --

10 Q Fuhr.

11 A -- or whatever, use the language that it  
12 should be easy and simple to access this market. You  
13 know you really want it to be as easy to change local  
14 companies as it is to change long distance companies.  
15 That means it's got to be done electronically. It  
16 means it's also got to happen at someplace in the  
17 network where changes can be done instaneously, which  
18 means they have to be done in the switch.

19 All of these things are out there. It's  
20 just going to take a while to get them up and  
21 operating and get this new environment underway.

22 COMMISSIONER JOHNSON: Thank you.

23 Q (By Mr. Fuhr) When do you foresee that  
24 AT&T or some other company will begin to engage in  
25 facilities-based competition?

1           **A**     Last year. Two years ago. Next year. I  
2 mean, it's going to differ and it's going to depend on  
3 the type of facility.

4                    People will put local switches in. Is that  
5 facilities-based competition? Evidently that's what  
6 it's called in this industry. But those are only  
7 going to be useful to serve selected markets. This is  
8 going to be very incremental.

9           **Q**     Recognizing that it gets hard to distinguish  
10 where the line gets drawn between short run and long  
11 run, when do you believe that AT&T or anybody else  
12 will attempt to duplicate the network that GTE has  
13 invested in and created in the state of Florida?

14           **A**     Is that question when do I believe that  
15 there will be a second network of the same size and  
16 scope of GTE's?

17           **Q**     Or one that is comparable. I mean -- if  
18 ever. I don't mean to presume it's going to occur.

19           **A**     Somewhere between ten years and never. And  
20 the issue really goes to wireless, I think. A second  
21 wire line network? I have a hard time contemplating  
22 the fact that there will be two or three wire line  
23 networks to every premise in GTE's territory. A  
24 wireless solution? It's conceivable.

25                    I've now moved from the implausible to the

1 plausible but there's still an awful lot of questions  
2 about the capacity requirements, the quality and when  
3 will we be so far along in the deployment of that that  
4 we don't run into spectrum constraints.

5 Q In your prefiled testimony you discuss in  
6 several different places the size of the investment  
7 that GTE has made in the network here in Florida, and  
8 I think you may also have the nationwide figures in  
9 your testimony; is that right?

10 A Yes.

11 Q And what role does the size of those  
12 investments play in your analysis as to when, if ever,  
13 there will be comparable networks developed by AT&T or  
14 others?

15 A The dollar size really plays no role. The  
16 physical size plays a big role.

17 There's some two and a half million access  
18 lines; probably I rounded that up. There's almost 240  
19 local switches. Even if we converted Dodge plants to  
20 switch manufacturing you couldn't build the switches  
21 you would need to replicate the local telephone  
22 network. On a national scale it's like 22,000 local  
23 exchange switches. In contrast, AT&T serves the  
24 entire country with about 130 switches in the long  
25 distance market. These really are fundamentally

1 different scale issues.

2 Q The investment in Florida, you have it in  
3 your testimony, how many billion dollars by GTE? You  
4 may recall it more quickly than I can find it.

5 A It's about 4 billion. Plant in service  
6 before depreciation, and I believe that that would  
7 include allocations of cost that might more  
8 appropriately be considered Dallas costs than Florida  
9 costs.

10 Q And from your perspective, GTE's investment  
11 in this network is part of what you lump into the  
12 concept "economic cost" that you mentioned earlier  
13 here today and I think you also have it in your  
14 prefiled testimony, correct? That is an economic cost  
15 that GTE is entitled to receive and is entitled to  
16 have taken into account in setting the prices by this  
17 Commission?

18 A No.

19 Q You don't believe that GTE's investment of  
20 \$4 billion in this network that you believe may never  
21 be duplicated should be taken into account in  
22 determining what prices GTE is entitled to receive for  
23 providing services to AT&T?

24 A Correct. That would not be an economic  
25 cost. I mean that's a book investment of GTE's which

1 includes things unrelated to providing network  
2 operations. They would include costs associated, I'm  
3 sure, with your national operations that have nothing  
4 to do with operator -- providing network elements.

5 Q But talking about the investment that has  
6 been made here in Florida, in the network itself, do  
7 we agree that GTE is entitled to have that investment  
8 taken into account when this Commission sets prices  
9 for the services it will be providing to AT&T?

10 A No, I don't believe so.

11 Q None of it at all?

12 A Well, we're going to get into a semantic  
13 argument here. I believe that when the Commission  
14 sets network element prices, it should compensate GTE  
15 on a going-forward basis all the costs it will incur  
16 to run and manage its network insofar as that involves  
17 of his telephone services. Your video trial and your  
18 other things shouldn't be included there. Your  
19 concept of what you call stranded cost but it's  
20 probably more appropriately labelled stranded monopoly  
21 profits shouldn't be included. You know, marketing  
22 administrative costs that are unrelated to network  
23 provisioning shouldn't be included.

24 Q What should be included?

25 A The forward-looking costs of running and

1 operating that network and provisioning those network  
2 elements both to yourselves and to other competitors.

3 Q Is there a cost of capital that GTE is  
4 entitled to receive?

5 A Yes.

6 Q And does not any of that relate to  
7 investments that it has heretofore made?

8 A That has nothing to do with it. It's the  
9 cost of capital associated with the return that you  
10 deserve, investments you would make on a  
11 forward-looking basis on this network.

12 Q So let's take a simple example.

13 If I go out and start a company and build a  
14 \$1,000 machine and that's all the costs that are  
15 required to prepare -- to manufacture widgets, and the  
16 incremental cost of producing those widgets is 50  
17 cents. Is it your testimony then that someone who  
18 wants to buy those widgets to resell under an  
19 analogous regime like we have here should only have to  
20 pay that 50 cent incremental cost; they should not  
21 have to make any compensation to the manufacturer or  
22 the owner of that \$1,000 machine so that they get back  
23 some of that \$1,000 investment and can recoup some of  
24 that investment?

25 A No.

1           Q     No, they should be entitled to get back some  
2 of that money?

3           A     They should be entitled to the  
4 forward-looking costs of producing widgets in a time  
5 frame that would encompass all of the costs associated  
6 with producing that, effectively, if you will, the  
7 TELRIC.

8                     In your example assuming that technology  
9 hasn't changed, and that this is the only cost  
10 structure at issue, then the TELRIC that you've  
11 described would include the \$1,000 machine. I believe  
12 your 50 cents was implicitly a short run incremental  
13 cost, which this is in my testimony, that the  
14 Commission ~~only~~ look at short run costs.

15          Q     So in that example where the machine does  
16 not get replaced, technology has plateaued or for  
17 whatever reasons there aren't new machines coming into  
18 the business, the owner of that machine is entitled to  
19 get compensated for his \$1,000 investment.

20          A     Yes, in the example, but it's not because  
21 he's spent \$1,000 on the machine. It's because if you  
22 were to do the study, the forward-looking cost of  
23 producing this would include the cost of a machine,  
24 and in this example the machine is \$1,000.

25          Q     And the reason it's forward-looking is



1 because of the assumption that there's not another  
2 machine that's coming along next year that's \$900 or  
3 \$800 or whatever; is that correct?

4 A Or \$1100 or \$1200.

5 Q Or \$1100 or \$1200, correct? That's the  
6 assumption that you're talking about.

7 A I think so. I'm having a little bit of a  
8 hard time following you on this, but I believe that  
9 that's correct.

10 Q All right. Moving right along. Let's move  
11 to Page 24 of your testimony. Line 16 through 18.  
12 You state there that if GTE is correct, that local  
13 rates are below cost, then both GTE and the entrant  
14 who has paid GTE for the cost of its facilities, will  
15 have a revenue shortfall. Do you see that?

16 A Yes.

17 Q Would you explain how the entrant will have  
18 a revenue shortfall?

19 A Because they have purchased the network from  
20 you in this example at its cost. So if you assume for  
21 a moment that the TELRIC of the network elements  
22 necessary to provide local exchange and exchange  
23 access service are \$10, and your local exchange rate  
24 by itself is \$8, GTE would make the claim that its  
25 local exchange service is below cost by amount of \$2.

1           Now, an entrant coming in would still pay  
2 you the \$10; presumably at best it could charge \$8 for  
3 local exchange service. So it, like you, would have  
4 from local exchange service, a shortfall. But again  
5 like you, since you are both providers of local  
6 exchange and exchange access service, would have that  
7 other revenue source available to it.

8           Q     This sentence then should not be read to  
9 suggest that if AT&T were able to acquire GTE's  
10 services below cost, that that in and of itself would  
11 cause a revenue shortfall to AT&T?

12          A     If I understood your question, I think I  
13 could agree this sentence isn't meant to imply that.  
14 Quite frankly, I'm so confused by that -- I never  
15 meant to imply what I think it is you just said.

16          Q     That's what I was asking you to verify, that  
17 you were not intending to imply that. And I think  
18 that's what you just said?

19          A     That's what I said, yeah.

20          Q     Okay. If this Commission were to set the  
21 prices too low, that is below GTE's economic costs,  
22 what effect would that have on GTE's abilities to keep  
23 this multibillion dollar investment in the network in  
24 Florida updated?

25          A     It would discourage it. We are talking

- 1 about network elements, relationship to cost, correct?
- 2 Q Yes.
- 3 A Okay. I just wanted to make sure.
- 4 Q And that would cause, in the long run, the  
5 network in Florida to decay, would it not?
- 6 A That's sort of a graphic term, but yes.
- 7 Q If the price is set --
- 8 COMMISSIONER GARCIA: What would cause it to  
9 decay? What was the question?
- 10 MR. FUHR: To decay.
- 11 COMMISSIONER GARCIA: What was the question?
- 12 MR. FUHR: The question was and the  
13 testimony was that if the price set by this  
14 Commission --
- 15 COMMISSIONER GARCIA: Got you.
- 16 Q (By Mr. Fuhr) If the price is set below  
17 GTE's economic costs, that would also cause too much  
18 entry to occur into this market; is that correct?
- 19 A From a economic perspective, yes.
- 20 Q And that is true in the short run, correct?
- 21 A Yes.
- 22 Q It's not true in the long run, correct?
- 23 A No, that's not clear to me at all.
- 24 Q Well, in the long run GTE cannot continue to  
25 provide its services below cost, correct?

1           **A**     Below its economic cost.

2           **Q**     Below its economic cost.

3           **A**     That would be true.

4           **Q**     Okay.  And so if GTE goes out of business  
5 because it goes belly up because it's providing all of  
6 these services to AT&T below costs, everyone else who  
7 is in the market suddenly loses their provider at  
8 below cost, then they have to turn to doing it  
9 themselves and some of them are going to find that  
10 they cannot stay in the business?

11          **A**     Okay.

12          **Q**     In the long run?

13          **A**     Yes.

14          **Q**     And that in the long run it would cause the  
15 number of people who were in the market to drop down,  
16 correct?

17          **A**     Yes.

18          **Q**     And that would cause disruption to the  
19 consumers of Florida, would it not?

20          **A**     Yes.  But there's nothing in my testimony  
21 that suggests I would encourage any of this to occur.

22          **Q**     In fact, you had a brief reference, I think,  
23 to the Rochester experiment, did you not, in which  
24 there was a problem where you had services below cost  
25 and you ended up having to pull the plug on that in

1 New York was it?

2 A AT&T had to cease marketing, yes.

3 Q And that presumably caused disruption to the  
4 consumers and the business clients in that community?

5 A Yes, I believe so, which is why it's so  
6 important not to overprice these as well.

7 COMMISSIONER JOHNSON: What? Your last  
8 statement, that's why it's important not to overprice  
9 these things as well. I didn't understand the  
10 connection, how you got there.

11 WITNESS GILLAN: How we got there was he  
12 started asking me about Rochester.

13 Rochester is notable both for its climate  
14 and the fact that it was the first city or first  
15 telephone company to try an arrangement where they  
16 permitted people to resell service.

17 The net result of that was everybody learned  
18 a lot of things, including the fact that you have to  
19 have some reasonable margin between retail and your  
20 wholesale costs, and you have to have operational  
21 systems. So in that example the competitive harm that  
22 occurred in the disruption to customers was that  
23 entrants had to cease marketing. Specifically AT&T  
24 could no longer offer local services in Rochester.  
25 That harm was a consequence of Rochester setting the

1 network prices too high.

2 His earlier questions all went to well, what  
3 will happen if GTE sets the network prices too low?  
4 And I guess we're going to -- you know, we could  
5 probably short circuit a lot of this if I just agree  
6 that Goldilocks is right, they can't be too high, they  
7 can't be too low. They have to be within a reasonable  
8 range of the economic cost.

9 COMMISSIONER JOHNSON: From a policy  
10 standpoint, to the extent that we're here trying to  
11 get it right, in determining which costing methodology  
12 to use, but what would your recommendation be as we're  
13 trying to get it right? Which side would we be more  
14 comfortable errorring on: Too high, too low?

15 WITNESS GILLAN: At the risk of making my  
16 client too happy I'd say too low, but there's a reason  
17 for it.

18 COMMISSIONER JOHNSON: Yeah.

19 WITNESS GILLAN: Long-run costs are higher  
20 than short run costs, so if you set these too low, so  
21 long as they are only in place in an interim  
22 arrangement, they're still going to be above the short  
23 run cost of these network elements.

24 If you set them, quote, "too low" what  
25 you're doing is you're setting them below what their

1 total long-run costs might be, but I don't believe  
2 that you would be setting them conceivably anywhere  
3 near what their short run cost to GTE are.

4           If you do that, in the short run you would  
5 be both compensating GTE for the short run costs and  
6 be encouraging entry. And, therefore, giving yourself  
7 some window to adjust these on a going-forward basis  
8 as you get more information.

9           Quite candidly, I don't see any way around  
10 the Commission not having to evaluate these prices  
11 periodically under any event, even if you had perfect  
12 information sitting here before you, there's going to  
13 have to be readjustments to these type of prices  
14 because things will change.

15           **COMMISSIONER JOHNSON:** What would happen if  
16 we did it the other way? Why would that be -- why  
17 wouldn't you recommend that?

18           **WITNESS GILLAN:** If you were to ask me that  
19 Bell's case, you know, last week I'd probably say all  
20 right, you're not getting any competition now, you  
21 just won't get any competition tomorrow, maybe there's  
22 not that dramatic a harm. You have a really unique  
23 problem here.

24           GTE got their side of the bargain. They got  
25 their pocket full of quid. They are in the local long

1 distance market. They're offering these things  
2 together. They are going to be the size of MCI this  
3 time next year if things go as they are.

4           So here you have a problem with not only are  
5 you not getting local competition, but you're seeing  
6 long distance competition be distorted by the absence  
7 of local competition. So my answer to you here is if  
8 you set them too high, not only do you not get local  
9 competition, but you're also going to get the added  
10 penalty of seeing less long distance competition in  
11 GTE's region as they continue to leverage this sort of  
12 unique status into that market.

13           **COMMISSIONER JOHNSON:** On the question that  
14 the gentlemen asked regarding setting the prices too  
15 low and GTE not being able to maintain its business  
16 and going out of business and what would then happen.  
17 What was your response to that?

18           **WITNESS GILLAN:** First of all, GTE's return  
19 to shareholder last year was 54 or 52%, so we're not  
20 talking about a company that's on the way to the dog  
21 house. That's really dramatic. I was impressed. I  
22 wish I had owned more stock in it.

23           So the idea that somehow you're going to  
24 take any action here that suddenly that you would  
25 allow to continue for such a long period of time that



1 it became obvious that that was the outcome, and yet  
2 you took no corrective action; you took no corrective  
3 action either through universal service arrangements;  
4 you took no corrective action in terms of the price in  
5 these network elements; that you took no corrective  
6 action on any dimension whatsoever is just absolutely  
7 inconceivable to me.

8           There's no way in the world that you're  
9 going to take any action here that you, as a  
10 Commission, would ever tolerate to exist for such an  
11 extended perpetual, you know, length of time that you  
12 would see these kind of outcomes.

13           Obviously he's asking me these questions so  
14 I'm going to give him the honest answer, that these  
15 would be the outcomes if you were to do these things  
16 and you were to ignore it, you know, for what would  
17 have to be maybe a decade. But if we put it in real  
18 practical terms today, where are we at?

19           Here's a company that had a return 54%.  
20 Here's a company that is being trumpeted throughout  
21 Wall Street as still a buy recommendation. Here's a  
22 company that's grabbing long distance market share I  
23 presume at a rate that's almost as fast as we can  
24 market it. Here's a company that continues to tell  
25 people that any kind of a loss we see on the local

1 side is going to be more than offset in long distance.  
2 Which I believe.

3 This whole Act is about local and long  
4 distance effectively merging. Right now you have it  
5 merging in one direction.

6 I just can't see that there's a real  
7 plausible scenario here that says that GTE's -- even  
8 if you set them, quote, "too short" even on an interim  
9 basis and of these evils would occur.

10 COMMISSIONER JOHNSON: Thank you.

11 Q (By Mr. Fuhr) Mr. Gillan, what is that 54%  
12 figure that you have been tossing about?

13 A You know, the Internet is a wonderful thing.  
14 It is from, I believe, your Annual Report as pulled  
15 down on the Internet.

16 Q My question is what is that defining? Is  
17 that return on equity?

18 A I will just read you your sentence, "Total  
19 return to GTE shareholders in 1995 was 52.4% compared  
20 to 49.3% for the regional Bell operating companies."

21 It would deal with share price  
22 appreciation -- the sentence before this is that GTE's  
23 primary financial objective to maximize shareholders  
24 long term total return consisting of share price  
25 appreciation and dividends." So it would have been

1 based on your stock appreciation last year and the  
2 dividend you paid out.

3 Q Because the return on equity for GTE last  
4 year was approximately 12%, was it not?

5 A That could be. But people don't buy equity  
6 as a commodity, they buy stock in your company, so the  
7 return to the shareholder is truly a more accurate  
8 reflection of what your financial performance was.

9 Q Would you turn to Page 30 of your testimony.  
10 Line 17.

11 In this section you are answering a question  
12 as to what is the basic approach for calculating the  
13 wholesale price for local services. Do you have that  
14 there in front of you?

15 A Yes.

16 Q And in your answer you state that the basic  
17 approach is to remove from the retail price, quote,  
18 "an estimate of the retail related costs that will be  
19 avoided by GTE as a wholesaler of services." Do you  
20 see that?

21 A Yes.

22 Q And would you explain how you believe that  
23 procedure should work?

24 A I'm not entirely sure I understand the  
25 question.

1 Q When you talk about removing from the retail  
2 price, quote, "an estimate" of the retail related  
3 costs, what is that estimate that you're referring to?

4 A It would be the amount of expenses  
5 associated with retailing activities in GTE's cost  
6 structure, a long run estimate, that you would remove  
7 from the retail price to establish the wholesale  
8 price.

9 Q And do you believe that methodology should  
10 be done by assuming that GTE will lose the entire  
11 market?

12 A Yes. Although when you assume that GTE  
13 would lose the entire market in terms of identifying  
14 the amount of expense adjustment, you're not really  
15 assuming that GTE would lose any amount of the market.  
16 You're simply saying that GTE's reduction will be  
17 proportionate to the number of customers it loses. So  
18 when you take an estimate of the full removal of  
19 retail costs, since you only apply that amount to the  
20 services that you actually provide to a reseller, it  
21 doesn't really assume that you're withdrawing from the  
22 market, because the only time you would fail to  
23 recover -- that you would recover none of these costs  
24 is if in actuality you lost the entire market. If you  
25 lost 10% of the market you'd see a reduction of 10%.

1 If you lost 20%, you'd see a reduction of 20%. So  
2 it's not actually assuming that you're not going to be  
3 participating in the retail market.

4 Q What assumption has AT&T made in its studies  
5 with respect to what percent of the market GTE will  
6 lose?

7 A I don't believe the AT&T study assumes that  
8 you will lose or retain any known percentage. It  
9 simply removes from your retail rates a 100% of your  
10 retailing costs. You only fail to actually realize  
11 that as you lose market share, but it doesn't actually  
12 assume that you're going to lose 100% of the market,  
13 it just backs out 100% of these retail costs. If you  
14 lost no customers, you would recover all of you  
15 retail -- you would have no amount of reduction  
16 experience. Boy, is this difficult for the English  
17 language.

18 The point simply is when you fully remove  
19 all of it in calculating the discount, the discount is  
20 only applied against the amount of the customer base  
21 that actually shifts to a reseller. So the reduction  
22 in your retail expenses tracks your reduction in  
23 market share. You only actually see 100% reduction if  
24 there is indeed a 100% reduction.

25 Q But where would GTE get compensated for

1 those retail costs that it is, in fact, continuing to  
2 incur if in the delivery of those services at  
3 wholesale prices the assumption is that GTE has none  
4 of those retail costs?

5       A     It only requires that GTE get its retailing  
6 cost from its retailing customers that you're not to  
7 get from your wholesale customers, the retail costs.

8             Just like AT&T would not be able to charge  
9 you for the customers it doesn't have. Each of you  
10 has some retail costs you, get your retail costs from  
11 your retail services; they get their retail costs from  
12 their retail services.

13       Q     Mr. Gillan, could you turn to Page 38 of  
14 your testimony, Line 22. You state there that "all  
15 providers should face the same effective cost for the  
16 use of a network component. The price charged other  
17 carriers must be equal to the economic cost of the  
18 element in question." Do you see that?

19       A     Yes.

20       Q     Should the new entrants pay any of the joint  
21 and common costs that GTE is paying?

22       A     Did you have the word "some" in that  
23 question.

24       Q     I don't believe I did, but I won't swear to  
25 it?

1           **A**     The answer is yes, with the clarification  
2 that the new entrant's cost for elements should  
3 recover the joint and common costs associated with the  
4 provision of network elements.

5           **Q**     If it is a cost that GTE incurs to deliver  
6 that element, to deliver that service, do you agree  
7 that AT&T should also pay for a portion of those  
8 costs?

9           **A**     Yes. With the sole exception -- I wouldn't  
10 characterize it as a service. There's really a whole  
11 different framework for elements and services.

12          **Q**     Let's make this more concrete. Let's turn  
13 to Page 39. On Line 13 you have a reference to the  
14 salary of the operations director. Do you see that?

15          **A**     Yes.

16          **Q**     What procedure would you use to allocate the  
17 cost such as the salary of the operations director?

18          **A**     I find considerable merit in the philosophy  
19 adopted in the FCC rules, which basically is that  
20 since there are some costs that are common to multiple  
21 network elements, but which can't be attributed to any  
22 individual one, that you would simply mark up the cost  
23 of each individual element by the proportion needed to  
24 cover these common costs. It's a simple,  
25 straightforward nonmanipulative recommendation.

1           Q     How do you determine what percentage to mark  
2 it up?

3           A     The denominator would be the cost of the  
4 individual elements, and the numerator would be the  
5 size of the common costs. In this case it would be  
6 the salary of the operations director, not necessarily  
7 the salary of your operations director, who might have  
8 responsibility for both telephone and video and other  
9 things, but the salary of an operations director  
10 commensurate with the requirements of managing a  
11 network element operation.

12          Q     That becomes part of the challenge, though,  
13 does it not? Do you take the salary of the operations  
14 director and a lot of other similar costs and you try  
15 to allocate them to a specific element, or do you  
16 describe them as joint and common? And that is an  
17 issue that in general you are proposing a fully  
18 distributing cost method, are you not?

19          A     No. Because a fully distributed cost  
20 method, as the term is typically used in this  
21 industry, implies the allocation of embedded and  
22 historic costs. We take away that sort of coloration  
23 to it.

24                   I am agreeing that this common cost, while  
25 incurred to provide network elements can't be



1 attributed to any one of them. And the FCC  
2 conclusion -- it seems reasonable to me to just  
3 allocate it across all in proportion to the individual  
4 cost.

5 Q Let me ask you a couple questions on access  
6 charges and we're finished.

7 On access charges, if you would turn to  
8 Page 41. In general you criticize that the access  
9 charges are set way too high, correct?

10 A In general I criticize that it's not  
11 actually part of this testimony to a significant  
12 degree.

13 Q That makes it simple, we can strike the last  
14 number of pages on this. Why are the access charges  
15 set at the rate they are set? Why are they set above  
16 cost?

17 A Because when they were initially established  
18 they were established to leave the LECs revenue  
19 neutral to the AT&T divestiture.

20 Q And the reason they had to be set above  
21 costs in order to make everything revenue neutral  
22 presumes that there are places where you are not  
23 recovering your costs, correct?

24 A No.

25 Q Why don't you explain that?

1           A     Well, you could overprice access and still  
2 have everything else cover its incremental cost. And  
3 the difference would be made up in excess cost, excess  
4 profits, some portion of joint and common costs.

5                     I'm not here really too concerned with which  
6 of those three explanations it is because I think  
7 under the framework here, one of the key elements is  
8 that whoever has the local customer is that customer's  
9 exchange access provider, and, therefore, to the  
10 extent that access charges are too high, people will  
11 have an opportunity to bring them down -- at least  
12 insofar as their own customers are concerned and the  
13 prices they charge those customers. But they can do  
14 so without having to raise local rates in any manner.

15           Q     One of the reasons access charges were set  
16 where they were was to ensure universal service at the  
17 rates that they were set, correct?

18           A     That's the convenient explanation for it. I  
19 think that access rates were set where they were to  
20 leave the LECs revenue neutral to an event. I'm not  
21 aware yet of a place where someone has seriously  
22 questioned whether or not those rate levels are  
23 necessary for universal service. They are certainly  
24 necessary if you want a 52% return to the shareholder.  
25 Somewhere between those extremes is an empirical

1 question that's not answered.

2 Q Speaking of empirical questions, what  
3 empirical study have you done of GTE's rates and GTE's  
4 costs and analysis as to whether those rates cover  
5 those costs?

6 A Well, I've reviewed a number of proprietary  
7 cost studies over the course of my lifetime. All we  
8 need is some walking-around logic here, Commissioners.

9 We're all familiar with GTE's ECS. At one  
10 point in life GTE in a sense said they needed all of  
11 those monies for universal service, so they had high  
12 toll rates in the Tampa LATA. You then authorized  
13 competition. GTE then dropped its prices for those  
14 toll well below access. Suddenly not only did they  
15 not need access charges from these calls -- or toll  
16 revenues from these calls, they didn't even need the  
17 access revenues. So now we have GTE's own behavior to  
18 show how questionable that assumption is.

19 Q Let me try my question again. In connection  
20 with your testimony in this hearing, have you done any  
21 empirical study of GTE's cost or the degree to which  
22 its prices cover those costs?

23 A They either are in excess of your cost or  
24 GTE is guilty of predatory pricing. Not only in the  
25 context of ECS but your own interLATA toll service

1 produces retail rates below your access charge rates.  
2 If the access charges truly reflect your costs, then  
3 you're predatorily pricing your toll service.

4

- - - - -

5 (Transcript continues in sequence in  
6 Volume 2.)

7

8

9

10

11

12

13

14

15

16

17

18

19

20

21

22

23

24

25