

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

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In the Matter of	:	DOCKET NO. 960847-TP
	:	DOCKET NO. 960980-TP
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 1996.	:	

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FIRST DAY - EVENING SESSION

VOLUME 5

Pages 504 through 627

PROCEEDINGS:	HEARING
BEFORE:	CHAIRMAN SUSAN F. CLARK COMMISSIONER J. TERRY DEASON COMMISSIONER JULIA L. JOHNSON COMMISSIONER DIANE K. KIESLING COMMISSIONER JOE GARCIA
DATE:	October 14, 1996
TIME:	Commenced at 6:00 p.m. Concluded at 7:50 p.m.
PLACE:	Betty Easley Conference Center 4075 Esplanade Way, Room 148 Tallahassee, Florida
REPORTED BY:	JANE FAUROT, RPR
APPEARANCES:	(As heretofore noted.)

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

(Hearing convened at 6:00 p.m.)

CHAIRMAN CLARK: Call the hearing back to order.

Mr. Fuhr.

MR. FUHR: Some good news, Your Honor, or Chairman Clark. I have no more questions of this witness.

CHAIRMAN CLARK: Okay.

MR. FUHR: To preserve my record, because we have this federal court review, let me just simply renew the motions and objections I have made to his testimony and to the exhibits that follow, recognizing that Mr. Wood may be coming in to lay a foundation, at which time I can renew again those motions. Thank you.

CHAIRMAN CLARK: You need to be specific as to your objection, what your objection is and what you are objecting to.

MR. FUHR: Thank you. On Mike Guedel's direct testimony, I would object to the consideration of and would move to strike the testimony that begins on Page 6, Line 16, and goes through Page 7, Line 4, Page 14, Line 14, through Page 19, Line 6, Page 6, Lines 8 through 14.

CHAIRMAN CLARK: Wait a minute.

MR. FUHR: I didn't do them in order because I had them broken down by subjects.

CHAIRMAN CLARK: Okay.

1 MR. HATCH: I'm confused. Could we have the list  
2 again. It just went off the track. The first one is Page  
3 6, Lines 16 through what?

4 MR. FUHR: Page 7, Line 4. The next one was Page  
5 14, Line 14, through Page 19, Line 6.

6 CHAIRMAN CLARK: Let me make a suggestion. Rather  
7 than taking up the time now to do it, why don't you make a  
8 list this evening and have it typed up and bring it in and  
9 let us know specifically what you're objecting to in the  
10 morning, and that way we will all have it in front of us and  
11 we will go over your objection at that time.

12 MR. FUHR: Thank you very much.

13 CHAIRMAN CLARK: Okay. No further questions?

14 MR. FUHR: No further questions.

15 CHAIRMAN CLARK: Staff.

16 Whereupon,

17 MIKE GUEDEL

18 having been called as a witness on behalf of AT&T  
19 Communications of the Southern States, Inc., and being duly  
20 sworn, continues his testimony as follows:

21 CONTINUED CROSS EXAMINATION

22 BY MS. BARONE:

23 Q Good evening, Mr. Guedel. Do you have staff's  
24 Exhibit MG-4 in front of you? That would be your deposition  
25 transcript and Late-filed Deposition Exhibit Number 1.

1           A     Yes.

2           Q     Sir, have you had an opportunity to review that?

3           A     Yes.

4           Q     Do you have any corrections to make at this time?

5           A     No, substantively it is accurate. There is  
6 probably a typo or two, but nothing substantive.

7           MS. BARONE: With that, Madam Chairman, staff  
8 requests that Exhibit MG-4 be marked for identification.

9           CHAIRMAN CLARK: It will be marked as Exhibit 12.

10          MS. BARONE: Thank you.

11          (Exhibit Number 12 marked for identification.)

12 BY MS. BARONE:

13          Q     Earlier, Mr. Guedel, I think you stated that you  
14 had a chance to review GTE-Florida's cost study after your  
15 deposition, is that correct?

16          A     Yes.

17          Q     Sir, based on your review of that cost study, are  
18 your comments and criticisms still the same?

19          A     Essentially, yes. I found upon my review of that  
20 study that several of the suppositions that I had concluded  
21 in my rebuttal testimony were, in fact, fact. For example  
22 -- and let me go to it. It's my understanding that the  
23 current GTE cost information with respect to local loops,  
24 for example, does not reflect a forward-looking mix of  
25 integrated versus non-integrated pair gain systems. I had

1 kind of thought that to be the case, and when I reviewed the  
2 study I now know that to be the case. I don't believe they  
3 have used an efficient crossover point between copper and  
4 pair gain systems in the loop study. I believe they have  
5 included in the loop study items such as sales expense and  
6 marketing expense, which are not appropriate expenses to  
7 contain in a TELRIC study for wholesale elements. There is  
8 some confusion as far as I'm concerned about some of the  
9 other cost factors, such as land and building loadings. I  
10 have absolutely no backup data to demonstrate to me how they  
11 came up with the factors that they include for land and  
12 buildings. I don't know if they were based upon historical  
13 land and building operation, in other words, that which is  
14 in place today or whether or not it was indeed a  
15 forward-looking analysis.

16 My feeling is still that it was an embedded  
17 analysis based upon other information that they have  
18 provided. For example, their calculation of common cost is  
19 a revenue requirements calculation. Their common cost is  
20 simply equal to, if I understand the study correctly, the  
21 1995 revenue requirement minus the sum of the TSLRIC. So we  
22 are back to a rate-based revenue requirement analysis on the  
23 part of GTE, and that is not consistent with forward-looking  
24 TELRIC analysis. So for these and probably a variety of  
25 other reasons, I found that the studies were flawed.

1 Q Are there any other assumptions that you can  
2 specifically identify in that cost study?

3 A I guess I would only add that, for example, the  
4 fill factor that was used with local loops is not consistent  
5 with what the Hatfield model would include for local loop  
6 fill factors. Again, the GTE number is low, which would  
7 inflate the price of the loop. And, again, looking at the  
8 price that they are recommending of \$33.08 or something like  
9 that for the local loop, and comparing that with the other  
10 information that is available, including the Hatfield model,  
11 including the FCC proxy, including a loop cost analysis that  
12 Southern Bell has presented before this Commission, which  
13 shouldn't be radically different than GTE, the \$33 number is  
14 extremely high by almost any cost standard that I have seen  
15 in a long time.

16 Q Sir, would you please turn to Exhibit MG-1, which  
17 is attached to your direct testimony?

18 A Yes.

19 Q Does your recommended switching price include the  
20 cost of carrying a call from the end office to the end user?

21 A Could you repeat that, please.

22 Q Does your recommended switching price include the  
23 cost of carrying a call from the end office to the end user?

24 A I'm trying to imagine the direction of that call.  
25 I think the answer is no, but if you're talking about from

1 the originator, you have to buy the loop to get to the  
2 switch. The local switching cost that I have included here  
3 includes all of the costs associated with that switch and  
4 all of the functions in that switch. It would not take into  
5 consideration transport costs that would be also incurred in  
6 taking a call to another office and to another end user.

7 MS. BARONE: Thank you. That's all I have.

8 CHAIRMAN CLARK: Commissioners. Redirect.

9 MR. HATCH: Just a couple.

10 REDIRECT EXAMINATION

11 BY MR. HATCH:

12 Q Mr. Guedel, how many years have you been  
13 conducting pricing and costing analysis?

14 A I have been involved in pricing and economic  
15 analysis in telecommunications for 16 years.

16 Q Based on your training, experience, and your  
17 knowledge of the Hatfield model, what is your opinion of the  
18 Hatfield model?

19 A Based upon my understanding of the Hatfield model,  
20 it is an accurate representation of the total element  
21 long-run incremental costs. The methodology is consistent  
22 with forward-looking cost technology, it is consistent with  
23 the prescriptions of the Federal Communications Commission,  
24 and it is the best cost study on the table today in this  
25 proceeding.



1           MR. FUHR: Objection. And I would move to strike  
2 that question and answer for the reasons that we discussed  
3 during my cross examination.

4           MR. HATCH: Madam Chairman, with respect to my  
5 question and with respect to the extensive cross examination  
6 by counsel, all I asked him was based on his knowledge,  
7 skills, training, and experience of the Hatfield what his  
8 opinion of it was. Now, to the extent counsel's cross goes  
9 to the credibility of that assessment, so be it.

10          CHAIRMAN CLARK: I'm going to leave the question  
11 and the answer in the record.

12          COMMISSIONER KIESLING: I was just going to  
13 suggest that if you have an objection, you ought to make it  
14 before he answers.

15          CHAIRMAN CLARK: I think he did, but I wasn't  
16 sure, because your mike wasn't on and when you didn't turn  
17 it on, I didn't know if you had decided not to.

18          MR. FUHR: No, what happened was when I spoke the  
19 microphone was not on, and when I pushed the microphone  
20 button on the witness was in the midst of his answer and I  
21 did not want to interrupt.

22          COMMISSIONER KIESLING: At your own risk.

23          CHAIRMAN CLARK: Let me reiterate we will not  
24 strike the question or the answer, and I would note that you  
25 have cross examined him on the basis of his opinions and his

1 study of the Hatfield study. Go ahead, Mr. Hatch.

2 MR. HATCH: That's all.

3 CHAIRMAN CLARK: Exhibits.

4 MR. HATCH: AT&T would move Exhibit 11.

5 MS. BARONE: Staff moves 12.

6 CHAIRMAN CLARK: Without objection, Exhibits 11  
7 and 12 are admitted in the record. Thank you, Mr. Guedel.

8 (Exhibits 11 and 12 received into evidence.)

9 WITNESS GUEDEL: Thank you.

10 MR. HATCH: AT&T would call Mr. Sather.

11 Whereupon,

12 L.G. SATHER

13 was called on behalf of AT&T Communications of the Southern  
14 States, Inc., and having first been duly sworn, was examined  
15 and testified as follows:

16 DIRECT EXAMINATION

17 BY MR. HATCH:

18 Q Have you previously been sworn, Mr. Sather?

19 A Yes, I have.

20 Q Could you please state your name and address for  
21 the record?

22 A My name is L.G. Sather, S-A-T-H-E-R. My business  
23 address is 1200 Peachtree Street Northeast, Atlanta, Georgia  
24 30309.

25 Q And by whom are you employed?

1           A     I am employed by AT&T.

2           Q     Did you prepare and cause to be filed in this  
3 proceeding direct testimony?

4           A     Yes, I did.

5           Q     Do you have any changes or corrections to any of  
6 your direct testimony?

7           A     Yes, I do. I have a number of corrections that  
8 are all basically of the same nature. The references to  
9 specific paragraphs in the FCC order are off by one number.  
10 The first correction is on Page 5, Line 14. The paragraph  
11 references 870 should be 871. Also on Page 5 at Line 20,  
12 the paragraph references 961 and 967, it should be 962 and  
13 968. On Page 10, Line 11, the paragraph reference 875  
14 should be 876. On Page 14, Line 16, paragraph reference 938  
15 should be 939. Those are the only corrections I have.

16          Q     Subject to those corrections, if I asked you the  
17 same questions that are contained in your testimony, would  
18 your answers be the same?

19          A     Yes, they would.

20               MR. HATCH: Madam Chairman, we would request that  
21 the direct testimony of Mr. Sather be inserted into the  
22 record as though read.

23               CHAIRMAN CLARK: It will be inserted into the  
24 record as though read.

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**DIRECT TESTIMONY OF**  
**L. G. SATHER**  
**ON BEHALF OF AT&T COMMUNICATIONS**  
**OF THE SOUTHERN STATES, INC.**  
**Docket No. 960847 - TP**

**Q. WILL YOU PLEASE IDENTIFY YOURSELF AND STATE YOUR BUSINESS ADDRESS?**

A. My name is L. G. Sather. My business address is 1200 Peachtree Street N.E., Atlanta, Georgia 30309.

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

A. I am employed by AT&T as a District Manager in the Government Affairs organization.

**Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.**

A. I have over thirty-five years of service in the telecommunications industry. I started my career at Northwestern Bell in 1960. My assignments at Northwestern included responsibilities in the installation and maintenance of local services, the engineering of local and toll distribution facilities, construction program planning, long range planning of local and toll networks, the determination and administration of local and toll switching machine capacities, network management of the toll network for

1 peak load conditions, and the economic analysis of network services in support of  
2 pricing decisions. In 1978, I transferred to South Central Bell. There I had  
3 responsibilities for economic analysis in the areas of Private Line Services, Data  
4 Phone Digital Services, Message Toll Service, WATS and 800 Service. From early  
5 1982 to December 1983, I worked on the development of state and interstate access  
6 charges for South Central Bell and the development of programs and analyses to  
7 support the interstate filing of the transport access charges for most of the Bell  
8 Operating companies. In 1984, I joined AT&T and have been involved with various  
9 aspects of regulatory and economic analysis relating to the provisioning of AT&T  
10 services.

11

12 **Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES WITH AT&T?**

13

14 A. I am responsible for presenting to regulatory bodies, industry fora, and AT&T  
15 management an analysis of industry proposals which impact AT&T's service  
16 offerings and capabilities in the nine AT&T Southern Region states. A major  
17 portion of my effort is directed towards achieving economically based,  
18 nondiscriminatory access charges and structures, together with regulatory rules that  
19 will allow AT&T to meet its customer needs with services that are competitively  
20 priced.

21

22 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY STATE PUBLIC**  
23 **UTILITY COMMISSIONS?**

24

25 A. Yes. I have testified in well over eighty proceedings throughout the southern region

1 on the following issues: appropriate pricing structures and levels for access,  
2 promotion of local and toll competition, competitive impacts of various industry  
3 proposals, and appropriate regulation of interexchange and local exchange carriers.

4  
5 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

6  
7 **A.** The purpose of my testimony is to recommend that the Commission issue an order  
8 directing GTE to offer for resale all of its retail telecommunications services at  
9 wholesale rates without resale restrictions. This is necessary to promote the  
10 development of competition in the local exchange market. By promoting  
11 competition, the Commission will secure for Florida consumers the benefits  
12 envisioned by the Act --high quality services and new technologies at competitive  
13 prices. On the other hand, GTE will stifle competition if the Commission allows  
14 GTE to restrict the types of services available for resale and the manner in which  
15 resellers can offer these services to Florida consumers. Indeed, GTE has a financial  
16 incentive to maintain its monopoly by limiting competition through imposing  
17 restrictions of the resale of local services. Unlike BellSouth, GTE does not have to  
18 satisfy the Act's fourteen point checklist in order to enter the interLATA market.  
19 GTE is there now! GTE, therefore, has nothing to lose and everything to gain by  
20 denying or delaying competition in the local exchange market.

21  
22 AT&T's experience is that GTE, if permitted, will deny consumers a competitive  
23 choice in order to maintain their monopoly position in the local exchange market.  
24 GTE has made every effort to stifle the development of intraLATA toll competition  
25 in Florida and other states. There is no reason to believe that GTE will act

1 differently here. The Commission must guard against anti-competitive behavior by  
2 taking a proactive role in requiring unrestricted resale of telecommunications  
3 services.

4  
5 **Q. WHAT DUTIES DOES THE TELECOMMUNICATIONS ACT OF 1996**  
6 **IMPOSE UPON GTE WITH RESPECT TO OFFERING**  
7 **TELECOMMUNICATIONS SERVICES FOR RESALE?**

8  
9 A. It is my understanding that Section 251(c)(4) of the Act imposes two duties on GTE  
10 and other incumbent local exchange companies. The first duty can be broken down  
11 into two parts: (i) GTE must offer for resale any telecommunications service that  
12 GTE provides at retail to subscribers who are not telecommunications carriers; and  
13 (ii) GTE must offer those telecommunications services for resale at wholesale rates.  
14 47 U.S.C. § 251(c)(4)(A). The Act defines *Telecommunications Service* as “the  
15 offering of telecommunications for a fee directly to the public, or to such classes of  
16 users as to be effectively available directly to the public, regardless of the facilities  
17 used. 47 U.S.C. § 153(46). The Act defines *Telecommunications* as “the  
18 transmission, between or among points specified by the user, of information of the  
19 user’s choosing, without change in the form or content of the information as sent  
20 and received.” 47 U.S.C. § 153(43).

21  
22 The second duty also can be broken down into two parts: (i) GTE shall not prohibit  
23 the resale of telecommunications services; and (ii) GTE shall not impose  
24 unreasonable or discriminatory conditions or limitations on the resale of  
25 telecommunications services. 47 U.S.C. § 251(c)(4)(B). The Act, however,

1 provides that the Commission -- not GTE -- may prohibit a reseller from offering  
 2 telecommunications services obtained at wholesale rates to a category of subscribers  
 3 who are not otherwise eligible to purchase those services at retail from GTE,  
 4 provided that any such prohibition is consistent with the Federal Communications  
 5 Commission ("FCC") regulations. 47 U.S.C. § 251(c)(4)(B).

6  
 7 **Q. HAS THE FCC ISSUED REGULATIONS IMPLEMENTING THE ACT?**

8  
 9 A. Yes. On August 8, 1996, the FCC released Order No. 96-325 and the regulations  
 10 implementing the Act. The order and regulations clarify and expand on certain  
 11 aspects of the Act. The FCC confirmed that GTE has a statutory obligation to offer  
 12 for resale at wholesale rates any telecommunications service that it provides at retail  
 13 to subscribers who are not telecommunications carriers. 47 C.F.R. § 51.605(a) (to  
 14 be codified); FCC Order No. 96-325, <sup>871</sup> ¶ 870, at 442 (Aug. 8, 1996). The FCC also  
 15 determined that resale restrictions are presumptively unreasonable except that State  
 16 Commissions have the discretion to prohibit the resale of: (1) residential services to  
 17 non-residential customers; (2) Lifeline or other means-tested service offerings to  
 18 non-eligible subscribers; and (3) withdrawn services to consumers that are not  
 19 current subscribers. 47 C.F.R. § 51.613(a)(1), 51.615 (to be codified); FCC Order  
 20 No. 96-325, <sup>962 968</sup> ¶¶ ~~961, 967~~, at 486, 488. GTE has the burden of proving to the State  
 21 Commission that any other resale restrictions are reasonable and non-discriminatory.  
 22 47 C.F.R. § 51.613(b) (to be codified). The Commission should take note that these  
 23 are extremely narrow restrictions.

24  
 25 **Q. HAVE REGULATORY BODIES PREVIOUSLY USED RESALE TO**



1           **PROMOTE COMPETITION IN THE TELECOMMUNICATIONS**  
2           **INDUSTRY?**

3  
4    A.     Yes. Resale was the primary vehicle that new entrants used to begin competing in  
5           the long distance market against AT&T, who previously had a monopoly on long  
6           distance service. Today, resale continues to play a major role in promoting  
7           competition in the long distance market.

8  
9    **Q.     DID REGULATORY BODIES PERMIT AT&T TO RESTRICT THE**  
10           **RESALE OF LONG DISTANCE SERVICES?**

11  
12   A.     No. The FCC required AT&T to offer for resale all of its services without  
13           restrictions. That requirement, which remains today, allowed companies like MCI,  
14           Sprint, and WorldCom (formerly LDDS and Wiltel) to establish themselves and  
15           succeed in the long distance market. The story of WorldCom demonstrates the  
16           value of resale in fostering competition. WorldCom started as a small reseller in  
17           Mississippi. Through the use of innovative management and effective resale of  
18           other carriers' services and facilities, WorldCom evolved from being a small local  
19           reseller to become the nation's fourth largest facilities based carrier.

20  
21   **Q.     DID CONSUMERS BENEFIT FROM THE COMPETITION IN THE LONG**  
22           **DISTANCE MARKET THAT RESALE HELPED CREATE?**

23  
24   A.     Yes. As the Commission is well aware, competition forced interexchange carriers  
25           like AT&T to drop their prices dramatically, add many new services, and deploy

1 new technologies.

2

3 **Q. WHAT TELECOMMUNICATIONS SERVICES HAS AT&T REQUESTED**  
4 **THAT GTE OFFER FOR RESALE AT WHOLESALE RATES?**

5

6 A. AT&T requested that GTE comply with the Act by offering for resale at wholesale  
7 rates any telecommunications service that GTE provides at retail to subscribers who  
8 are not telecommunications carriers. AT&T also requested that GTE not impose  
9 any resale restrictions on those services.

10

11 **Q. WHAT WAS GTE'S RESPONSE TO AT&T'S REQUEST?**

12

13 A. GTE proposed to restrict AT&T's resale of telecommunications services in two  
14 ways. First, GTE proposed to restrict the types of services it would offer for resale  
15 at wholesale rates. Second, GTE proposed to place use and user restrictions on the  
16 services that GTE would offer for resale.

17

18 **Q. HOW DID GTE PROPOSE TO RESTRICT THE TYPES OF SERVICES IT**  
19 **WOULD OFFER FOR RESALE AT WHOLESALE RATES?**

20

21 A. GTE stated that some services will not be available for resale. Other services will  
22 be available for resale, but not at wholesale rates.

23

24 **Q. WHAT TYPES OF SERVICES DID GTE REFUSE TO OFFER FOR**  
25 **RESALE?**

1

2 A. It is AT&T's understanding, based on a culmination of communications, that GTE  
3 would not agree to offer all of its retail telecommunications services for resale.  
4 Listed below are some but not all of the types services that GTE refused to offer for  
5 resale and AT&T's understanding of the basis of GTE's position. Given the vast  
6 amount of information that the parties have exchanged and the dynamic nature of  
7 negotiations, it is possible that AT&T may misunderstand some of GTE's positions  
8 on the resale of local exchange services. Certainly, the best source for GTE's  
9 position is GTE itself. Nevertheless, I have tried to summarize GTE's position for  
10 the convenience of the Commission.

11

12 • Withdrawn Services -- Often referred to as grandfathered services, these are  
13 telecommunications services available only to a limited group of customers  
14 who have purchased such services in the past. GTE argues that the Act does  
15 not cover withdrawn services because such services are not offered to the  
16 general public. Exhibit RS-1, Tab 112, at 2. AT&T asserts that the Act's  
17 definition of telecommunications services includes withdrawn services  
18 because GTE offers withdrawn services to "such classes of users as to be  
19 effectively available directly to the public." 47 U.S.C. § 153(46). The FCC  
20 regulations confirm the validity of AT&T's position by providing that GTE  
21 must make withdrawn services available at wholesale rates so that AT&T  
22 can offer such services to the same limited group of customers. 47 C.F.R.  
23 § 51.615 (to be codified).

24

25 • Promotional Offerings -- These are retail services offered at special prices.

1 GTE argues that it should not have to make its promotional offerings  
2 available to AT&T because promotions are short term and offered at GTE's  
3 discretion. Exhibit RS-1, Tab 112, at 2-3. The FCC Order established a  
4 presumption that promotional prices offered for a period of 90 days or less  
5 need not be offered at wholesale rates. FCC Order 96-325, ¶ 949, at 480.  
6 AT&T believes that Incumbent Local Exchange Carriers like GTE can and  
7 will use promotional offerings to avoid their duty to offer retail  
8 telecommunications services at wholesale rates. The Commission,  
9 therefore, should reject or tightly control any exception for promotional  
10 offerings from GTE's resale obligation.

- 11
- 12 • "Below Cost" Residential Services -- These are retail residential services  
13 that GTE offers at retail rates that are purportedly below the cost of  
14 providing that service. GTE argues that it should not have to offer these  
15 services for resale. Exhibit RS-1, Tab 112, at 3. The Act and its  
16 implementing regulations, however, do not exempt services that are  
17 provided at below cost from GTE's duty to offer any retail  
18 telecommunications service for resale at wholesale rates. See 47 U.S.C.  
19 § 251(c)(4)(A); 47 C.F.R. §§ 51.605(a), 51.613(a) (to be codified).  
20
  - 21 • In Contact Services -- These are retail services that utilize AIN triggers  
22 within the GTE's switch to allow customized call handling, such as having  
23 calls delivered to one location at specified times and to another location at a  
24 different time. GTE has not agreed to offer such services for resale. Exhibit  
25 RS-1, Tab 112, at 3. The Act and its implementing regulations, however, do

1 not exempt In Contact Services from GTE's duty to offer any retail  
2 telecommunications service for resale at wholesale rates. 47 U.S.C.  
3 § 251(c)(4)(A); 47 C.F.R. § 51.605(a), 51.613(a) (to be codified).

- 4
- 5 ● Payphone Services -- These are services for public, semi-public, and  
6 customer-owned, customer-operated telephones. GTE argues that the Act  
7 does not require GTE to offer such services for resale at wholesale rates.  
8 Matrix 5. The FCC order, however, provides that Incumbent Local  
9 Exchange Carriers must offer certain payphone services for resale at  
10 wholesale rates to telecommunications carriers like AT&T. FCC Order No.  
11 96-325, ¶ <sup>876</sup>875, at 444.

12

13 **Q. WHAT TYPES OF SERVICES DID GTE AGREE TO OFFER FOR RESALE,  
14 BUT NOT AT WHOLESALE RATES?**

15

16 A. The types of services that GTE agreed to offer for resale but not at wholesale rates  
17 included, but are not limited to:

- 18
- 19 ● Discount Calling Plans and Packages -- GTE argues that these plans reflect  
20 GTE's economic cost savings from dealing in bulk and should not be  
21 offered at wholesale rates. Exhibit RS-1, Tab 112, at 3. The Act and the  
22 implementing regulations, however, do not exempt discount calling plans  
23 and packages from GTE's duty to offer any retail telecommunications  
24 service for resale at wholesale rates. See 47 U.S.C. § 251(c)(4)(A); 47  
25 C.F.R. §§ 51.605(a), 51.613(a) (to be codified).

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- Non-Recurring Charge Services -- These are services that are provided and billed on a non-recurring basis. GTE argues that it does not avoid any costs in providing these services at wholesale. Exhibit RS-1, Tab 112, at 3. The Act and its implementing regulations require that GTE must offer for resale at wholesale prices any telecommunications service sold at retail to subscribers who are not telecommunications carriers. 47 U.S.C. § 251(c)(4)(A); 47 C.F.R. §§ 51.605(a), 51.613(a) (to be codified). Non-recurring charges are retail prices. Consequently, GTE must offer such services for resale at wholesale rates.

**Q. WHY SHOULD THE COMMISSION REQUIRE GTE TO OFFER FOR RESALE ALL RETAIL SERVICES AT WHOLESALE RATES?**

- A.** First, the Act and its implementing regulations require GTE to offer for resale at wholesale rates any telecommunications service that GTE provides at retail to subscribers who are not telecommunications carriers. 47 U.S.C. § 251(c)(4)(A); 47 C.F.R. § 51.605(a) (to be codified).
- Second, even if there were not a strict legal requirement that GTE offer for resale all retail telecommunications services at wholesale rates, the availability of resale under such conditions has significant public interest benefits. Resale fosters competition which benefits consumers because it leads to higher quality services and new technologies at competitive prices. The Commission only has to look at the interexchange market to see how consumers benefit from the competition that resale

1           helped create. By requiring GTE to offer for resale all retail services at wholesale  
2           rates, the Commission provides all consumers with a real choice for all  
3           telecommunications services.

4  
5           Third, requiring GTE to offer all telecommunications services for resale at  
6           wholesale rates creates a bright-line test to determine GTE's compliance with its  
7           statutory duties. That bright-line test will prove to be an effective and efficient  
8           regulatory tool because the Commission will not have to police any exception to  
9           GTE's resale duties, or at most only a few limited exceptions that the Commission  
10          deems appropriate and consistent with the FCC regulations. Allowing GTE to  
11          restrict the types of services it would offer for resale at wholesale rates, on the other  
12          hand, would provide a giant loophole for anti-competitive behavior such as  
13          grandfathering customers to prevent competition in select market segments or  
14          abusing promotions to avoid offering services for resale at wholesale rates. Absent  
15          a bright-line test, new entrants would have to petition the Commission each time  
16          GTE attempts to exclude a service from its duty to offer that service for resale at  
17          wholesale rates. A bright-line test, therefore, will reduce the need for regulatory  
18          intervention.

19  
20       **Q.    WHAT ARE USE AND USER RESTRICTIONS?**

21  
22       **A.    Use and user restrictions are limitations that local exchange carriers impose to limit**  
23       **who can purchase a particular service and how that consumer can use the service.**

24  
25       **Q.    WHAT IS THE ORIGIN OF USE AND USER RESTRICTIONS?**

1

2 A. Use and user restrictions are a by-product of pricing practices in a non-competitive,  
3 monopolistic environment. In the past under rate of return regulation, pricing often  
4 reflected social objectives (like minimizing the rates for residential basic local  
5 exchange service) rather than reflecting the underlying cost to provide a particular  
6 service. Local exchange carriers would satisfy the majority of their revenue  
7 requirements by pricing non-residential services as high as possible and would raise  
8 rates for residential service only as a last resort. Large business customers with  
9 leverage in the marketplace would object to the high rates and the local exchange  
10 carrier would respond by lowering rates for those large business customers. In the  
11 end, some customers were paying much higher rates than other customers for  
12 essentially the same service. As a result, the local exchange carrier had to create use  
13 and user restrictions to protect its ability to generate sufficient revenues by  
14 preventing one class of customers from taking advantage of lower prices offered to a  
15 different class of customers.

16

17 Most States now have stopped rate of return regulation. Use and user restrictions,  
18 however, remain in place.

19

20 **Q. WHAT IS GTE'S POSITION REGARDING USE OR USER**  
21 **RESTRICTIONS?**

22

23 A. GTE's position is that the Act permits GTE to impose reasonable and  
24 nondiscriminatory restrictions on resale. Exhibit RS-1, Tab 112, at 2. It is AT&T's  
25 understanding that GTE believes that all current category-to-category resale



1 restrictions are reasonable and non-discriminatory, and should remain in place. The  
2 one exception is that GTE will permit resellers to offer business services to  
3 residential customers.

4  
5 **Q. ARE SUCH USE AND USER RESTRICTIONS APPROPRIATE IN THE**  
6 **RESALE ENVIRONMENT?**

7  
8 **A.** No. The Act and its implementing regulations do not permit use and user  
9 restrictions in the competitive resale market. The Act provides that Incumbent  
10 Local Exchange Carriers like GTE cannot impose unreasonable or discriminatory  
11 conditions or limitations on the resale of telecommunications services. 47 U.S.C.  
12 § 251(c)(4)(B). The FCC regulations implementing the Act provide that all resale  
13 restrictions are presumptively unreasonable and that GTE has the burden to prove to  
14 the Commission that a particular resale restriction is reasonable and  
15 nondiscriminatory. 47 C.F.R. § 51.613(b) (to be codified); FCC Order No. 96-325,  
16 ¶ <sup>939</sup>938, at 476. The only recognized exception to the prohibition against resale  
17 restrictions is that State Commissions, and not GTE, have the discretion to restrict  
18 the resale of: (1) residential services to non-residential customers; (2) Lifeline or  
19 other means-tested service offerings to non-eligible subscribers; and (3) withdrawn  
20 services to consumers that are not current subscribers. 47 C.F.R. § 51.613(a)(1),  
21 51.615 (to be codified).

22  
23 Competition is the new order in telecommunications, and resale restrictions are  
24 incompatible with competition. While use and user restrictions may have served a  
25 legitimate purpose in the past, such restrictions now only serve to limit competition.

1 All local exchange carriers should be able to offer telecommunications services to  
2 anyone for any lawful purpose and should not be bound by restrictions imposed by  
3 competing carriers. That will help ensure robust competition.

4

5 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

6

7 **A.** AT&T has requested that GTE offer all of its retail telecommunications service for  
8 resale at wholesale prices and without resale restrictions. That is what the Act and  
9 the FCC regulations require, and that is what is necessary to promote robust  
10 competition. GTE, however, has refused to agree to AT&T's reasonable request.  
11 Consequently, AT&T requests that the Commission order GTE to: (1) offer for  
12 resale at wholesale rates any telecommunications service that GTE provides at retail  
13 to subscribers who are not telecommunications carriers; and (2) offer those  
14 telecommunications services for resale without any resale restrictions.

15

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

17

18 **A.** Yes.

1 BY MR. HATCH:

2 Q You had no exhibits to this testimony, is that  
3 correct?

4 A That is correct.

5 Q Do you have a summary of your testimony, Mr.  
6 Sather?

7 A Yes, I do, very briefly.

8 Q Please give that.

9 A Good afternoon, Commissioners. It's a pleasure to  
10 still be in Tallahassee. The testimony I'm going to present  
11 today is very similar to what I presented with respect to  
12 the BellSouth case. AT&T's position is the same with  
13 respect to resale requirements, and GTE's position is very  
14 similar to that of Bell. I would iterate that the quickest  
15 way to put consumers first and give all Florida consumers  
16 choices for a full range of telecommunications services is  
17 resale.

18 My testimony asks the Commission to require GTE,  
19 as I requested of BellSouth, that they be ordered to offer  
20 at resale at wholesale rates any telecommunications service  
21 which GTE provides at retail to subscribers who are not  
22 telecommunications carriers. This Commission should also  
23 order GTE to offer services for resale without unreasonable  
24 or discriminatory use or user restrictions. This means  
25 creating a new competitive environment. A clean slate, if

1 you would, with respect to removing all existing use and  
2 user restrictions. The three restrictions that AT&T  
3 believes are reasonable were identified by the FCC in its  
4 report and order and goes to the areas of, one, withdrawn  
5 services or grandfathered services, where they could only be  
6 resold to grandfathered customers. The other area relates  
7 to the restriction to allow that residential services  
8 purchased at wholesale rates may not be resold to business  
9 consumers. The third area relates to promotional offerings,  
10 that promotional offerings have a period of less than 90  
11 days would not be available at wholesale prices.

12 GTE, however, much the same as BellSouth, puts  
13 forth the view that a number of other resale restrictions  
14 are appropriate. They also request the grandfathered  
15 services not be available for resale. Such services as  
16 Lifeline, LinkUp 911 be restricted from resale.  
17 Additionally, it appears that they believe all existing used  
18 and user restrictions in the tariff should remain. Again, I  
19 would indicate that the ability to implement such use and  
20 user restrictions on resale will effectively eliminate  
21 resale as an effective tool to promote competition. There  
22 is mention made of the concern for selling below cost  
23 services. I would iterate that there should be no financial  
24 impact on GTE as a result of reselling services whether they  
25 are below cost or not. The formula clearly indicates that

1 the rate for the wholesale rate is the retail rate minus the  
2 costs that would be avoided. GTE should be financially  
3 indifferent under that scenario whether they made a  
4 wholesale or retail transaction.

5 Resale has been an effective regulatory tool in  
6 both promoting competition and in disciplining retail  
7 prices. This has been the experience in the interexchange  
8 industry since divestiture and before AT&T was required to  
9 make all of its services available for resale without  
10 restriction. That capability allowed MCI, Sprint, and  
11 others to enter the market in one fashion and to become  
12 formidable competitors in the long distance market in a much  
13 shorter period of time than would have otherwise been  
14 possible. Additionally, with respect to Worldcom, I think  
15 it is noteworthy that they have moved from a very small  
16 resaler in Mississippi to the fourth largest facility-based  
17 carrier in the long distance market using resale as a  
18 primary vehicle to achieve that prominence.

19 Commissioners, I would ask that all resale  
20 restrictions be removed from existing tariffs and that GTE  
21 be required to offer all of its services for resale. Resale  
22 restrictions can be an effective manner in restricting  
23 competition. I would note with respect to GTE that they do  
24 not have the same incentive as does BellSouth to make its  
25 services available for resale. Consequently, I think the

1 Commission should take added caution with regard to any  
2 potential ability they have to further restrict competition.  
3 That concludes my summary.

4 MR. HATCH: We tender the witness for cross.

5 CHAIRMAN CLARK: Mr. Melson.

6 MR. MELSON: No questions.

7 MS. CASWELL: I do have a few questions, Mr.  
8 Sather.

9 CHAIRMAN CLARK: Ms. Caswell.

10 CROSS EXAMINATION

11 BY MS. CASWELL:

12 Q Were you aware that in the rebuttal testimony of  
13 GTE Witness Wellemeyer, GTE withdrew its proposed  
14 restriction on grandfathered services?

15 A No, I was not. I looked at it, I guess I don't  
16 recall that that was withdrawn from view.

17 Q We will now -- well, you can read it for yourself.  
18 GTE will now agree to offer for resale at wholesale rates  
19 grandfathered services.

20 A All right.

21 Q Is it AT&T's position that GTE should be required  
22 to resale promotions at a discount regardless of the  
23 duration of the promotion?

24 A That was our initial position. What we have  
25 indicated in this testimony is basically that we are willing

1 to comport with restrictions as identified by the FCC. That  
2 being that with respect to promotions, that if they are a  
3 period longer than 90 days, they should be available at the  
4 wholesale price. If they are available for a period of less  
5 than 90 days, they should be available at the resale price  
6 or at the wholesale price prior to the promotional level.

7 Q When GTE sells you a service at wholesale, you set  
8 a retail price, is that right?

9 A That's correct.

10 Q And you might, for example, reduce your customary  
11 retail rate to meet a promotion by GTE for the same service  
12 on a temporary basis, is that also true? It's a  
13 possibility?

14 A Certainly.

15 Q So you could compete with GTE's promotions without  
16 receiving a discount from GTE's promotional rate, isn't that  
17 also true?

18 A Well, that's an over-generalization. I guess to  
19 the extent of how deep the discount is or specifically what  
20 it is, AT&T in this new environment, as it is today, is free  
21 to offer promotions at any time. To the extent that it can  
22 counter the offers of other competitors, it intends to do  
23 so.

24 Q Okay. If GTE gives you a discount off its already  
25 reduced promotional rate, it can't ever counter your

1 promotional rate with that discount, can it?

2 A I believe the requirement here is that the  
3 wholesale price must be made available if the promotion is  
4 more than 90 days. And I think the rationale put forth by  
5 the FCC, while I don't disagree with everything, I believe  
6 is interesting. You are saying that if it is in effect for  
7 longer than 90 days it is not a promotion and, therefore,  
8 not a retail rate. If it meets the criteria of a retail  
9 rate, by the 1996 act, it must be made available at  
10 wholesale prices.

11 Q Is that a presumption or a requirement, the beyond  
12 90 days part of the FCC order?

13 A As I understand the proposal of the FCC order,  
14 that -- well, let's see, a requirement. It is suggested by  
15 the FCC order. Clearly the state Commission can modify that  
16 requirement at its discretion and based on evidence this  
17 Commission receives.

18 Q When you talk about use and user restrictions, are  
19 you referring to cross category restrictions, such as a  
20 prohibition on reselling residential service to business  
21 customers?

22 A No. That cross class selling restriction AT&T  
23 agrees with. The used and user restrictions I'm talking  
24 about would be such items that merely labeling it as  
25 available for hotel/motel or something else, makes it



1 unusable by AT&T for anyone else. If we meet the terms and  
2 conditions of an offering, we should be able to sell it to  
3 anyone who can utilize that service. We package it with  
4 other items without restriction. It's those type of  
5 restrictions we are talking about.

6 Q Okay. And in your testimony, I think you  
7 indicate, and this is on Page 13, that use and user  
8 restrictions were a function of pricing based on social  
9 objectives rather than the cost of service. Is that an  
10 accurate paraphrase?

11 A I think that's a reasonable description.

12 Q So the premise for your argument against use and  
13 user restrictions is that with the elimination of rate of  
14 return regulations prices reflect their cost rather than  
15 social objectives, would that also be true?

16 A That's a large part of it, and I think that's a  
17 large underlying thrust of the entire telecommunications  
18 act, promoting competition, it's moving all areas to  
19 economically efficient pricing. And in doing that there are  
20 a number of things taking place that if there are to be any  
21 subsidies, they must be explicit. And implicit subsidies  
22 and pricing must be removed. So this is part of the overall  
23 process in moving to economically efficient pricing and  
24 promoting competition.

25 Q And are you familiar with Florida's statutory

1 price regulation scheme and this Commission's implementing  
2 regulations?

3 A I have read it, and I don't recall all aspects of  
4 it, no.

5 Q Do you know, in fact, that rates were not  
6 rebalanced to reflect their cost in Florida?

7 A Rates, as I understand the parties that went under  
8 price regulation did so at their request to eliminate rate  
9 of return type of constraints. And I believe any party that  
10 feels that they would be better served by remaining under  
11 rate of return regulation is fully capable of doing that.  
12 While I am concerned that a number of proposals of GTE  
13 reflecting going back to that type of requirement, I don't  
14 see the other part of fulfilling that and saying that  
15 earnings will be reduced to reflect only a reasonable  
16 return.

17 Q But would you agree that the implicit subsidies  
18 you talked about were not, in fact, removed from prices when  
19 price regulation came into effect?

20 A I believe so. The implicit subsidies I have in  
21 mind, let's say the source of them, primarily from access  
22 charges, access has not moved totally toward a cost-based  
23 level. So there is a subsidy flowing from access charges.  
24 Now what we have yet to determine is where that subsidy is  
25 flowing. As part of the universal service initial hearing

1 before this Commission, it was my view that it was flowing  
2 primarily to the profits of the local exchange company. The  
3 local exchange service was extremely profitable and it was  
4 not, in fact, can subsidized at all. Therefore, if there is  
5 a source of a subsidy and it is still flowing, I guess the  
6 question is where is it going.

7 MS. CASWELL: I have no further questions. Thank  
8 you, Mr. Sather.

9 CHAIRMAN CLARK: Staff.

10 CROSS EXAMINATION

11 BY MR. PELLEGRINI:

12 Q Good evening, Mr. Sather. I'm Charlie Pellegrini  
13 representing the staff.

14 A Good evening, Mr. Pellegrini.

15 Q Just a few questions. Let me turn you initially  
16 to Page 4 of your direct testimony. There at Line 10 and  
17 11, you state that the first duty can be broken down into  
18 two parts. GTE must offer for resale any telecommunications  
19 service that GTE provides at retail to subscribers, with any  
20 underlined, is that correct?

21 A Yes.

22 Q Nevertheless, do you understand the act to  
23 preclude any services from resale?

24 A The only service that I believe it precludes is a  
25 wholesale service and access. And in that regard, I guess

1 any service that is here goes back to the view any service  
2 that is offered at retail to nontelecommunications customers  
3 are the other part of it. But the wholesale service of  
4 access is not made available for resale.

5 Q On Page 10 next.

6 A Yes, sir.

7 Q Line 16 through 25, you talk there about that GTE  
8 has agreed to offer for resale discount calling plans and  
9 packages and nonrecurring charge services, but not at  
10 wholesale rates, is that correct?

11 A Yes, that was my --

12 Q Why do you believe that it is inappropriate for  
13 GTE to charge wholesale rates for discount calling plans and  
14 packages?

15 A You mean why is it appropriate they charge  
16 wholesale rates?

17 Q Why do you believe it to be inappropriate?

18 A Wait. I'm saying it is appropriate that they  
19 offer -- GTE believes that it should not offer some items at  
20 wholesale rates.

21 Q Why do you feel that position is inappropriate?

22 A Regarding discounted calling plans, I believe that  
23 if it is the term discounted calling plan merely an optional  
24 calling plan, it is a resale service and should be made  
25 available at wholesale rates. Merely because it is termed a

1 discounted plan doesn't remove it from that requirement to  
2 be available for resale. I think it's important in some of  
3 this discussion to separate the requirement of what we are  
4 asking for as a wholesale pricing requirement. This is not  
5 an arbitrary discount. The wholesale pricing requirement  
6 merely says that the retail cost should be removed from that  
7 offering, and, therefore, it becomes a wholesale offering.  
8 So it's not a discount on a discount. It's merely saying  
9 what services need to be made available at a wholesale rate.

10 Q On Page 11, with reference to nonrecurring  
11 charges, you make the observation that GTE argues that it  
12 does not avoid any costs in providing these services at  
13 wholesale. Can you explain why you believe -- or do you  
14 agree that GTE does not avoid any costs in providing these  
15 services at wholesale?

16 A No, I believe there are significant retail costs  
17 included in the nonrecurring charges. For example, it is  
18 very common to include the preponderance of service order  
19 processing and activities that will be done by the reseller  
20 in this new environment. To the extent that retail costs  
21 are included in nonrecurring charges, they should be avoided  
22 or voidable when they are performed by another party. So,  
23 therefore, it's the same as any other rate associated with  
24 the service.

25 Q On Page 12 at Lines 6 through 7, there you talk

1 about a bright line test?

2 A Yes.

3 Q Can you explain in a little bit more detail what  
4 you mean by a bright line test?

5 A Yes. What we are trying to get at is the removal  
6 of all use and user restrictions. That it should be obvious  
7 that services are available for resale, period. That  
8 existing use and user restrictions must be removed. We  
9 cannot promote competition in this environment and have  
10 creeping resale restrictions put into the process. Let me  
11 give you an example. If you have limited restrictions in  
12 regard to contract service offerings, for example, and if  
13 then GTE is allowed to enter into a contract for any of its  
14 service arrangements and not make that available for resale,  
15 or under restricted conditions, it is really saying that  
16 they can ignore the tariffing process, move all of their  
17 services to a contract arrangement, and totally avoid the  
18 ability of anyone to compete. Any part of these resale  
19 restrictions produces the same thing. And it's kind of like  
20 a bottleneck doesn't have to be long, it merely has to be  
21 effective. And any restriction that creeps into this  
22 process can dampen the promotion of competition. Therefore,  
23 I would caution the Commission to view very cautiously any  
24 such restrictions.

25 Additionally, I think it's very safe to approach

1 this from the view that there has never been a resale  
2 restriction that was put in to promote consumer choice.  
3 Resale restrictions, as I indicate in my testimony, were put  
4 in to allow pricing discrimination. Be that it had a social  
5 objective, that objective was never consumer choice. That  
6 is the direction we are going today. And as Mr. Cresse  
7 indicated, these are the tools really the Commission now has  
8 to work with most effectively to ensure that consumers do  
9 benefit and that there is pricing discipline.

10 Q My final question, Mr. Sather. Based on your  
11 interpretation of the act, are the restrictions which GTE  
12 proposes reasonable and nondiscriminatory?

13 A I think that any restrictions beyond the three  
14 items identified in my testimony are unreasonable. That GTE  
15 has now agreed to grandfathered service offerings, I believe  
16 that is a step in the right direction. But any existing  
17 restrictions is carry-over in their tariffs. If we are  
18 allowed to say how you use the service or whom you can  
19 resale it to, does not promote an effective competitive  
20 arrangement nor does it give consumers choice. If we  
21 applied that view to the auto industry, and saying if you  
22 could buy a car, but you are not allowed to have anyone else  
23 ride it in unless the auto manufacturer says you have a  
24 shared service agreement, if you are not allowed to sell  
25 that car or charge someone for a ride, that doesn't promote

1 effective use of facilities or really is an unreasonable  
2 infringement on people's rights. Because these restrictions  
3 have existed for a number of years in the industry and were  
4 based on a social pricing objective, they were reasonable at  
5 the time but that time has changed, the game rules have  
6 changed, and the restrictions need to be removed.

7 Q Let me be certain, the three exceptions that you  
8 mentioned are those that you describe on Page 5 of your  
9 testimony?

10 A I believe that's correct.

11 Q Namely, residential service to non-residential  
12 customers, Lifeline, or other means tested service --

13 A Correct.

14 Q -- and withdrawn services?

15 A Correct. And the promotions of less than 90  
16 days.

17 MR. PELLEGRINI: Thank you, Mr. Sather.

18 CHAIRMAN CLARK: Commissioners. Redirect.

19 MR. HATCH: No redirect.

20 CHAIRMAN CLARK: Thank you, Mr. Sather.

21 WITNESS SATHER: You're welcome, Madam Chair.

22 MS. DUNSON: AT&T calls Art Lerma.

23

24 Whereupon,

25

ART LERMA



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

4 DIRECT EXAMINATION

5 BY MS. DUNSON:

6 Q Mr. Lerma, were you previously sworn?

7 A Yes.

8 Q Would you please state your name and business  
9 address for the record.

10 A My name is Art Lerma, and my business address is  
11 1200 Peachtree Street Northeast, Atlanta, Georgia 30309.

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

13 A I am employed by AT&T as area controller.

14 Q Did you cause to be prepared 22 pages of direct  
15 testimony which was prefiled on behalf of AT&T in this  
16 proceeding on August 16th, 1996?

17 A Yes, I did.

18 Q Do you have any changes or corrections to your  
19 direct testimony?

20 A No, I do not.

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

24 A Yes, they would.

25 MS. DUNSON: Madam Chairman, I request that Mr.

1 Lerma's direct testimony be inserted into the record as  
2 though read.

3 CHAIRMAN CLARK: It will be inserted in the record  
4 as though read.

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1 DIRECT TESTIMONY OF  
2 ART LERMA  
3 AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.  
4 BEFORE THE  
5 FLORIDA PUBLIC SERVICE COMMISSION  
6 DOCKET NO. 960847-TP  
7  
8 Q. PLEASE IDENTIFY YOURSELF.  
9  
10 A. My name is Art Lerma and my business address is Promenade I, Room 5082, 1200  
11 Peachtree Street, Atlanta, Georgia, 30309.  
12  
13 Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL  
14 BACKGROUND AND EXPERIENCE.  
15  
16 A. In 1974, I received a Bachelor of Arts degree in Mathematics from Trinity  
17 University in San Antonio, Texas. In 1994, I received a Master of Business  
18 Administration from St. Edwards University in Austin, Texas with a concentration  
19 in General Business and Telecommunications Management.  
20  
21 Q PLEASE DESCRIBE YOUR CURRENT EMPLOYMENT, THE SCOPE OF  
22 YOUR RESPONSIBILITIES, AND YOUR PRIOR WORK EXPERIENCE.  
23  
24 A. I am employed by AT&T as Area Controller - Regional Controller Organization.  
25 As Area Controller, I have responsibility for AT&T's financial matters and for

1 certain local exchange carrier ("LEC") cost analysis functions in the southern states  
2 area. In 1974, I began my career with Southwestern Bell as a supervisor in  
3 Accounting Operations responsible for accounts receivable processing and revenue  
4 journalization. From 1975 through 1983, I held various line and staff positions at  
5 Southwestern Bell Accounting Centers where I was responsible for data processing  
6 operations, toll operations, customer billing and collection, payrolls, accounts  
7 payable, and the production of corporate books and records. In July of 1983, I  
8 transferred to AT&T and accepted the position of Manager - Accounting Regulatory  
9 Support responsible for AT&T financial regulatory matters in Texas. From 1983  
10 through 1988, I was primarily involved with the review of LEC cost information  
11 filed before the Texas Public Utility Commission or in other regulatory proceedings  
12 involving potential changes to access charges. In 1989, I accepted the position of  
13 District Manager - Financial Regulatory Matters.

14

15 **Q. PRIOR TO THIS DOCKET, HAVE YOU REVIEWED ANY GTE AVOIDED**  
16 **COST DATA?**

17

18 **A. Yes. As a result of AT&T's negotiations with GTE under the Telecommunications**  
19 **Act of 1996 ("Act"), GTE provided a copy of an avoided cost study which I have**  
20 **had the opportunity to review.**

21

22 **Q. DESCRIBE THE LEVEL OF YOUR FAMILIARITY WITH GTE'S**  
23 **AVOIDED COST DATA.**

24

25 **A. I have compared the above referenced GTE data with data filed by GTE in its**

1 Automated Reports Management Information System ("ARMIS") reports, with the  
2 Federal Communications Commission ("FCC"). Furthermore, I have performed a  
3 detailed analysis of this cost study to assess GTE's compliance with the Act.  
4

5 **Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE ANY COMMISSION OR**  
6 **OTHER REGULATORY AUTHORITY?**  
7

8 A. Yes. I filed testimony before the Texas Public Utility Commission in Dockets 7330  
9 and 8585. I have filed testimony before the Arkansas Public Service Commission in  
10 Docket No. 86-159U. I have filed testimony before the Tennessee Public Service  
11 Commission in Docket No. 95-02499 and Docket No. 96-00067. I have also  
12 testified before the North Carolina Public Utilities Commission in Docket Nos. P-7,  
13 Sub 825 and P-10, Sub 479 and the Georgia Public Service Commission in Docket  
14 No. 6352-U. Lastly, I have filed testimony before the Florida Public Service  
15 Commission in Docket No. 960833-TP.  
16

17 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**  
18 **PROCEEDING?**  
19

20 A. The purpose of my testimony is to describe AT&T's recommendation for  
21 establishing wholesale rates for services sold by GTE to AT&T for resale by AT&T  
22 to Florida consumers.  
23

24 More specifically, I discuss:  
25

- 1           1. my opinion regarding the requirements of the Act with respect to wholesale rates  
2           for services subject to resale;  
3  
4           2. the methodology used by AT&T to calculate an avoided retail cost percentage  
5           reduction of 30.9% (see Exhibits AL-4 and AL-5) that should be applied to GTE's  
6           local service retail rates to determine wholesale rates; and  
7  
8           3. a preliminary assessment of my analysis of GTE avoided cost data studies  
9           obtained as a result of AT&T's negotiations with GTE under the Act.

10  
11   **Q.    DOES THE ACT ADDRESS HOW THIS COMMISSION SHOULD**  
12   **DETERMINE WHOLESALE RATES FOR GTE SERVICES THAT MAY BE**  
13   **RESOLD?**

14  
15   **A.**    The Act provides substantial guidance for determining the wholesale rates for  
16           services that incumbent LECs, such as GTE, must sell to other carriers for resale.  
17           The specific language in 47 U.S.C. § 252(d)(3) is that "a State commission shall  
18           determine wholesale rates on the basis of retail rates charged to subscribers for the  
19           telecommunications service requested, *excluding the portion thereof attributable to*  
20           *any marketing, billing, collection, and other costs that will be avoided by the local*  
21           *exchange carrier."* (Emphasis added.) Thus, to determine wholesale rates, the Act  
22           identifies three specific categories of costs that are to be excluded from retail rates:  
23           marketing, billing, and collection costs. The Act also prescribes the removal from  
24           retail rates of any "other costs that will be avoided." Effectively, the Act prescribes  
25           that *all* retail-related costs are to be removed from retail rates to establish wholesale

1 rates.

2

3 **Q. WHAT IS THE BASIS FOR YOUR CONCLUSION THAT THE ACT**  
4 **REQUIRES THAT WHOLESALE PRICES NOT INCLUDE ANY GTE**  
5 **RETAIL-RELATED COSTS?**

6

7 A. The Act's specific reference and exclusion of marketing, billing, and collection  
8 (which includes physical payment processing costs, as well as uncollectible costs)  
9 from retail rates suggests that the Act's language "other costs that will be avoided"  
10 describes costs other than marketing, billing, and collection that will not be incurred  
11 because of resale. In other words, if Congress had intended to limit avoided costs  
12 only to marketing, billing, and collection costs, there would have been no need for  
13 Congress to have included "other costs that will be avoided" in the Act. There are  
14 various types of costs that vary with volumes of customers lost to resellers so that  
15 when any incumbent LEC loses a customer, the incumbent LEC's retail costs  
16 decrease. However, the Act's specific exclusion of marketing, billing, and  
17 collection costs from retail rates also shows that "other costs that will be avoided"  
18 must include not only all costs directly caused by retailing functions, but also any  
19 costs from functions that indirectly benefit or support retailing activities. As an  
20 example, with respect to marketing costs, I believe this conclusion is logical because  
21 Congress must have realized that competition in some cases will cause incumbent  
22 LECs to spend more, not less, for certain marketing activities as the local service  
23 market becomes more competitive. Thus, for some types of marketing costs, such  
24 as those related to advertising, GTE may opt to maintain or increase its current  
25 levels of retail advertising although not for the benefit of resellers who will be

1 purchasing wholesale services. The basis for the Act's exclusion of marketing costs  
2 to arrive at a wholesale rate, therefore, is that such costs reflect functions that vary  
3 with volumes (such as retail sales functions) and functions caused by or only  
4 benefiting retailing activities.

5

6

AT&T'S MODEL

7

8 **Q. PLEASE SUMMARIZE HOW AT&T DETERMINED THE AMOUNT OF**  
9 **GTE RETAIL COSTS THAT SHOULD BE EXCLUDED FROM GTE'S**  
10 **RETAIL RATES.**

11

12 **A.** AT&T used its "Avoided Retail Cost Model" (the "Model") to identify all types of  
13 GTE costs associated with retail activities occurring in the local services market.  
14 The end result is a percentage that should be used to reduce GTE's local services'  
15 retail rates in order to reflect the retail costs GTE will avoid when it provides local  
16 services on a wholesale basis to AT&T.

17

18 **Q. WHAT ARE LOCAL SERVICES?**

19

20 **A.** Local services include basic area message services such as flat rate local services,  
21 measured local services, "vertical" features such as call waiting and forwarding and  
22 expanded area calling plans.

23

24 **Q. WHY DOES THE MODEL FOCUS ON LOCAL SERVICES?**

25



1 A. AT&T has focused on the development of wholesale local services rates because  
2 this is the first services category in which AT&T intends to compete with GTE.  
3 However, the Model also can be used to develop separate wholesale rates for a  
4 number of other services categories, such as toll and private line.

5

6 **Q. DOES AT&T'S MODEL DEVELOP REASONABLE WHOLESALe RATES**  
7 **FOR GTE'S LOCAL SERVICES?**

8

9 A. Yes.

10

11 **Q. WHY DOES AT&T'S MODEL DEVELOP APPROPRIATE WHOLESALe**  
12 **RATES FOR GTE'S LOCAL SERVICES?**

13

14 A. The Model uses a methodology that is reasonable, as described further in this  
15 testimony, and that reflects the best available public data. Thus, I believe it  
16 generates appropriate wholesale rates for GTE's local services. If GTE wishes to  
17 challenge the results of AT&T'S study based upon "better" data, then, in all fairness  
18 to AT&T and this Commission, GTE should disclose *all* necessary data for analysis  
19 by AT&T and this Commission. Until that happens, the most reasonable means for  
20 measuring wholesale rates are the data that are currently available.

21

22 **Q. UPON WHAT PUBLICLY AVAILABLE DATA DOES AT&T RELY?**

23

24 A. AT&T relies upon the ARMIS reports that GTE filed with the FCC for the year  
25 1995. The specific data that AT&T uses are obtained from the following ARMIS

1 reports:

2

3 ARMIS 43-03 (Joint Cost Report): This report provides the regulated annual  
4 operating results of GTE for every account in the FCC's Part 32 Uniform System of  
5 Accounts ("USOA"). Those data are used to supplement the data from the ARMIS  
6 43-04 report.

7

8 ARMIS 43-04 (Access Report): This is the primary data source for the Model. The  
9 report provides regulated financial and operating data separated in accordance with  
10 Part 36 and Part 69 of the FCC's Rules.

11

12 ARMIS 43-08 (Operating Data Report): This report is used as a source of operating  
13 data. Table III of the report is used to identify access lines associated with switched  
14 services. Information on toll calls and billed access minutes is derived from  
15 Table IV of the report.

16

17 **Q. PLEASE SUMMARIZE THE AT&T MODEL.**

18

19 **A.** The objective of the Model is to measure all retail costs which will be avoided by  
20 GTE when wholesaling services to AT&T and to express the total of the costs as a  
21 percentage of GTE's retail rates. The Model is divided into three "phases," each of  
22 which is described in detail below. Overall, Phase I assigns revenues and costs into  
23 seven separate categories; Phase II reorganizes revenues and costs for those seven  
24 categories into the five traditional lines of business; and Phase III analyzes the costs  
25 assigned to local services to identify costs that will be avoided and calculates the

1 appropriate reduction to local services retail rates to produce wholesale local service  
2 rates. The modeling process is displayed graphically as shown in Exhibit AL-1.

3

4 **Q. PLEASE DESCRIBE PHASE I IN MORE DETAIL.**

5

6 A. Phase I of the Model assigns revenues and costs from the ARMIS 43-04 report to  
7 one or more of six separate functional categories and the residual is accumulated in  
8 an unassigned seventh category: Billing and Collection; Directory; Intrastate Private  
9 Line; Special Access; Subscriber Line; Minute Driven; and Unassigned. For certain  
10 line items on the 43-04 report that appear on an aggregated basis, the relative  
11 percentages calculated from the more detailed 43-03 accounts are applied to  
12 separate the aggregated line items. These Phase I categories are more fully  
13 described by expense categories in Exhibit AL-2 (Treatment of ARMIS Data).  
14 Wherever possible, revenue and expenses are directly assigned to a functional  
15 category. For expenses that cannot be directly assigned, they are apportioned based  
16 on the characteristics of the expense incurred, operational data, and factors as set  
17 forth in Exhibit AL-3 .

18

19 **Q. PLEASE DESCRIBE PHASE II IN MORE DETAIL.**

20

21 A. Phase II of the Model takes the revenues and costs assigned to the seven categories  
22 in Phase I and ultimately groups the revenues and expenses into five traditional lines  
23 of business: Miscellaneous; Private Line; Local; Access; and Toll. Phase II has  
24 four steps. Step 1 groups the seven Phase I categories into four consolidated  
25 operational categories: Miscellaneous (Billing & Collection, Directory and Public

1 Telephone); Private Line (Intrastate Private Line and Special Access); Subscriber  
2 Line; and Minute Driven. Step 2 assigns Minute Driven expenses to Subscriber  
3 Line, access service and Interoffice categories. Step 3 assigns Interoffice expenses  
4 to Toll Service and Local interoffice. In Step 4, Local Interoffice and Subscriber  
5 Line are consolidated to generate Local costs. The Phase II assignment of revenues  
6 and costs to lines of business is further detailed in Exhibit AL-2 by type of expense.

7  
8 **Q. THE ALIGNMENT PROCESS YOU JUST DESCRIBED SEEMS COMPLEX**  
9 **-- WHY DO YOU BELIEVE THE ALIGNMENT PROCESS TO BE**  
10 **REASONABLE?**

11  
12 A. As stated previously, AT&T has used the best information available to determine  
13 costs that will be avoided when GTE provides local services on a wholesale basis.  
14 Adequate, *service-specific* data is currently unavailable. The AT&T Model,  
15 therefore, aligns GTE's ARMIS revenues and costs with logical categories of  
16 services using direct assignment where possible and reasonable apportionment  
17 elsewhere. Every cost reflected on the ARMIS 43-04 report that could not be  
18 directly assigned is apportioned to a category of services identified in the Model  
19 using assignment methodologies and factors that are consistent with the unique  
20 characteristics of the function generating the cost. Because apportionment of costs  
21 to several services categories is necessary, in some cases complex calculations are  
22 required. The alignment process used in the Model is as reasonable as possible,  
23 given information that is publicly available .

24  
25 **Q. PLEASE DESCRIBE PHASE III IN DETAIL.**

1  
2 A. In Phase III, local services costs that will be avoided when GTE provides wholesale  
3 services to AT&T are identified, aggregated and expressed as a percentage of local  
4 services retail revenues. The Model identifies local services costs that will be  
5 avoided in two steps: (1) it identifies *direct* retail costs; and (2) it identifies costs  
6 incurred in support of direct retail functions performed (*indirect* costs).

7  
8 First, the model identifies *direct* costs that will be avoided based on the following  
9 criteria: (1) one of three types of costs that the Act specifically identifies as costs  
10 that will be avoided; (2) costs that will be duplicated by the reseller when it sells at  
11 retail; or (3) costs that are caused by GTE's retail activities. The types of costs that  
12 the Model identifies as direct costs which will be avoided based upon these criteria,  
13 including the FCC USOA account or ARMIS line item reference, and the rationale  
14 for that identification, are as follows:

15  
16 1) **Uncollectibles** (included in account 5300): Costs related to uncollectibles  
17 will be avoided 100 percent because the risk for collection of open accounts  
18 receivables from retail end user customers moves from the incumbent LEC  
19 to the reseller (*i.e.*, if the end user does not pay, the reseller accepts the  
20 financial responsibility).

21  
22 2) **Marketing** (includes accounts 6611-Product Management, 6612-Sales, and  
23 6613-Product Advertising): The Act specifically lists "marketing" costs as  
24 costs that will be avoided. The FCC's Uniform System of Accounts for  
25 Telecommunications Companies states that marketing "shall be used . . . to

1 summarize" the costs of Product Management, Sales and Product  
2 Advertising. 47 C.F.R. § 32.6610. Moreover, in the USOA, the  
3 descriptions of Product Management ("administrative activities related to  
4 marketing products and services"), Sales ("cost incurred in selling products  
5 and services"), and Product Advertising ("costs incurred in developing and  
6 implementing promotional strategies to stimulate the purchase of products  
7 and services") clearly reflect that each of these costs are marketing costs. In  
8 addition, AT&T will incur all of these types of costs when selling at retail.  
9 Thus, the Model identifies 100% of all such GTE costs as costs that will be  
10 avoided.

11

12 In addition, all costs related to end user order processing and other customer  
13 operations, such as investigating customer accounts and instructing  
14 customers in the uses of customer services and products, are reflected under  
15 the marketing category in AT&T'S Model. These types of costs are  
16 included in account 6623. AT&T intends to perform all end user customer  
17 service functions utilizing electronic interfaces. Thus, the Model identifies  
18 100% of GTE's marketing costs as costs that will be avoided.

19

20 3) **Billing and Collection** (included in account 6623 along with other customer  
21 expense): Again, the Act specifically lists billing and collection costs as  
22 costs that will be avoided. AT&T'S Model includes all billing related costs  
23 such as postage and billing inquiries, as well as bill payment collection  
24 costs. The Model identifies 100% of these GTE costs as costs that will be  
25 avoided.

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4) **Operator-Related Expense**, includes accounts 6621 - call completion services, 6622 - number services (directory assistance), ARMIS 43-04 line 6040 - Depreciation-Operator Systems, and account 6220 - Network-CO operator systems: Operator costs clearly are retail related. They are not caused by nor do they provide a benefit to a reseller buying wholesale services. Moreover, if AT&T achieves direct routing of local telephone calls to its operators, as AT&T has requested, all operator costs become costs that GTE will avoid. The Model identifies 100% of GTE's operator related costs as costs that will be avoided.

5) **Operations Testing and Operations Plant Administration** (included in account 6533 and 6534): AT&T has requested an electronic interface with GTE's service trouble reporting database. This will allow AT&T to perform both immediate and high quality initial trouble analysis when a customer reports trouble on his line. Based on AT&T'S experience, about 50% of its own testing and plant administration costs involve end user customers. Based on this data, AT&T conservatively estimates that approximately 20% of GTE's customer related testing and plant administration costs will be avoided.

Second, moving from *direct* cost categories, the Model also identifies that portion of *indirect* costs (including common costs and other indirect costs) that relate to retail activities that also will be avoided. In summary, not identifying indirect costs that are attributable to retail activities will result in resellers subsidizing the cost of

1 GTE's retail functions. Moreover, such costs likely will be duplicated by resellers.  
 2 Thus, those portions of indirect costs attributable to retail services are costs that will  
 3 be avoided under the Act. The measurement of the portion of these indirect costs  
 4 that retail functions cause or benefit from, and thus which will be avoided in a  
 5 wholesale environment, is described below:

6  
 7 1) **Network Support Expenses** (included in account 6110) and **General**  
 8 **Support Services** (included in account 6120): Network support expenses  
 9 include all costs of transport, including motor vehicles, aircraft, other  
 10 special purpose vehicles and maintenance equipment. General Support  
 11 Services includes Accounts 6120 through 6124 - General Support Expenses  
 12 includes Land, Building, Furniture, Artwork, Office Equipment and General  
 13 Purpose Computer. The amount of Network and General Support Expenses  
 14 that will be avoided equals:

$$15$$

$$16 \quad \text{Expense} \quad \times \quad \frac{\text{Direct local costs that will be avoided}}{\text{Total local costs minus total local indirect costs}}$$

$$17$$

18  
 19 This formula results in a ratio that reflects the relationship between "total  
 20 avoided" local direct costs and "total" local direct costs. The application of  
 21 this ratio is reasonable because support expenses will vary directly in  
 22 proportion to the changes in direct costs that will be avoided. For example,  
 23 in a wholesale environment, GTE's retail sales expenses will be avoided,  
 24 and therefore, support assets utilized in the retail sales function no longer  
 25 will be necessary for the wholesale provisioning of local services.



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2) **Depreciation-General Support** (as reflected on ARMIS line 6020): These avoided costs are determined using the formula and for the same reasons described in preceding paragraph 1 above.

3) **Executive and Planning** (account 6710), **General & Administrative** (account 6720), and **Operating Other Taxes** (account 7240). These avoided costs are determined using the formula and for the same reasons described in paragraph 1 referenced above.

4) **Return and Income Taxes:** Generally, cost studies reflect return and income tax components of costs. The portion of return related to support assets that are avoided, and the appropriate federal income taxes that should be assigned to this category of costs that will be avoided is multiplied by a factor determined by the following formula:

<u>General Support facilities investment</u>	X	<u>Direct costs that will be avoided</u>
Total Telephone Plant-in Service		Total local costs minus total local indirect costs

5) **Other Interest deductions:** This category represents that portion of costs associated with interest on customer deposits (as reflected in account 7540) which will be avoided because deposits will now be held by resellers. Consequently, the interest that must be paid on deposits will be incurred by resellers and thus avoided by GTE.

1

2 **Q. HOW IS THE AGGREGATE AMOUNT OF COSTS THAT WILL BE**  
3 **AVOIDED DETERMINED IN AT&T'S STUDY?**

4

5 **A** Exhibit AL-4 provides a summary and Exhibit AL-5 provides the details of the  
6 results of the AT&T Model. These exhibits identify both the direct and indirect  
7 retail costs that will be avoided, as well as the appropriate local services category  
8 revenues. Total avoided direct and indirect retail costs are then divided by the  
9 appropriate local services revenues to derive the specific percentage of 30.9%. This  
10 percentage represents the amount of GTE's retail costs that will be avoided when  
11 GTE sells local services to AT&T on a wholesale basis. This percentage then is  
12 applied to all local services rates to arrive at the wholesale price GTE should be  
13 entitled to charge AT&T for local services.

14

15 Exhibit AL-5 provides supporting detail for all local revenues and costs considered  
16 by the Model. The first column, labeled "Total Local BU," provides GTE's  
17 revenues and costs pertaining to a total local business unit or line of business  
18 developed through phases I and II of AT&T'S model. The column labeled "avoided  
19 retail cost factor" is the percentage of each local cost category that relates to retail  
20 functions, as just discussed. The column labeled "avoided retail amount" is the  
21 product of the specific local services costs in the first column multiplied by the  
22 avoided retail cost factor in the second column.

23

24 All pertinent revenues and costs then are converted to a per subscriber line basis.  
25 The retail costs that will be avoided is obtained, by dividing the per line local

1 services retail costs that will be avoided, by the local services revenues per line.  
2 The local services revenues per line then serves as average rates per line. With  
3 respect to GTE, the Model identified the local services retail costs that will be  
4 avoided by GTE to be \$7.66 per line per month. The per line retail costs that will be  
5 avoided, divided by the local services revenues of \$24.75 per line per month,  
6 produces 30.9 percent, which is the percent amount by which GTE retail prices  
7 should be reduced to achieve wholesale prices.

8

9 **Q. WHAT IS THE SIGNIFICANCE OF THE AVOIDED RETAIL COST**  
10 **PERCENTAGE?**

11

12 A. This percentage, when applied to the retail prices of particular GTE local services,  
13 effectively removes the costs of retail functions from GTE's retail rates for those  
14 services.

15

16 **Q. DOES THE AVOIDED RETAIL COST PERCENTAGE PRODUCED BY**  
17 **THE MODEL DIRECTLY RESULT IN A SINGLE WHOLESALE RATE**  
18 **FOR LOCAL SERVICES?**

19

20 A. No, it only leads to arriving at the wholesale rate for local services. The Model  
21 develops a single avoided retail cost percentage for local services. However, to  
22 calculate wholesale rates for services, that percentage is applied to the retail prices  
23 which GTE charges its retail subscribers for any local services sold at retail. This  
24 process is as follows:

25

1  $P_W = P_R - (P_R \times \text{Avoided Retail Cost Percentage})$

2  $P_W =$  Price at wholesale

3  $P_R =$  Price at retail

4

5 **Q. WHY DOES AT&T PROPOSE A SINGLE AVOIDED LOCAL RETAIL**  
6 **COST PERCENTAGE?**

7

8 A. The primary reason is that avoided cost data, relating to specific local services that  
9 GTE offers, currently is not available to AT&T or to this Commission for that  
10 matter. This includes a lack of revenues and avoided cost data relating to residential  
11 versus business customers.

12

13 If this data is made available to AT&T, AT&T will be able to analyze it to determine  
14 if the data is sufficient and appropriate for use in developing an avoided retail cost  
15 percentage for individual types of services to which the data applies.

16

17 **Q. DOES THE AT&T MODEL INCLUDE COSTS, OTHER THAN DIRECT, AS**  
18 **COSTS THAT WILL BE AVOIDED?**

19

20 A. Yes, as I discussed earlier in my testimony, that portion of indirect costs that are  
21 caused by or that benefit retail functions are considered costs that will be avoided.

22

23 **Q. DOES AT&T'S MEASUREMENT OF COSTS THAT WILL BE AVOIDED**  
24 **ALLOW GTE TO RECOVER ANY OF ITS JOINT AND COMMON COSTS?**

25

1 A. Absolutely. Joint and common costs that are caused by, or provide benefit to  
2 wholesale functions, would be recovered by GTE in the wholesale price it charges  
3 AT&T for wholesale services. Remember, the avoided retail cost percentage only  
4 removes those direct and indirect retail costs, including portions of joint and  
5 common costs, which are associated with retail functions. Joint and common costs  
6 associated with wholesale functions remain in the wholesale price.

7  
8 **Q. DOES A WHOLESALE RATE THAT EXCLUDES ALL RETAIL COSTS**  
9 **RESULT IN A BELOW COST RATE?**

10

11 A. No. The key to understanding this concept is to appreciate that GTE's local services  
12 rates cover all of its costs because of either of two factors: (1) the rates themselves  
13 cover all of GTE's wholesale costs, or (2) the rates, plus subsidies received from  
14 other local services rates (e.g., custom calling services) or other classes of service  
15 (e.g., subscriber line charges), cover all of GTE's wholesale costs. Thus, although  
16 wholesale prices for particular services might appear to be under cost, GTE  
17 continues to receive these subsidies and, thus, is fully compensated for its wholesale  
18 costs.

19

20 **Q. HAVE YOU PERFORMED AN ANALYSIS OF ANY AVOIDED COST**  
21 **STUDY DATA PREPARED BY GTE?**

22

23 A. As stated previously, I have analyzed GTE avoided cost studies provided during  
24 negotiations held in conjunction with the Act between AT&T and GTE. There are  
25 numerous questions that I have concerning the avoided cost data that GTE has made

1 available at this time. AT&T will be active in the discovery stage of the arbitration  
2 process in an attempt to obtain additional data and clarifications concerning the GTE  
3 study. Nonetheless, the following is a preliminary assessment of the analysis  
4 performed:

5

6 (1) GTE's study is a national study that does not include avoided cost information at  
7 the state level for the states in which they do business. AT&T'S cost study is  
8 performed using specific GTE state data and it is difficult to compare to this  
9 nationwide study.

10

11 (2) GTE's cost study is based on work center detail for which there is no  
12 comparison to actual booked costs by account as available on the ARMIS reports  
13 publicly filed by GTE with the FCC.

14

15 (3) There are a large number of cost categories for which GTE has not calculated  
16 avoided costs and which appear to be related to retailing functions.

17

18 (4) GTE's study includes speculative adjustments to reflect new wholesale costs that  
19 are not specifically supported by the Act.

20

21 (5) GTE has inappropriately made adjustments to remove non-recurring costs.

22

23 (6) GTE's calculated discounts appear to be significantly understated.

24

25 Q. **HAVE YOU REVIEWED THE FCC'S FIRST REPORT AND ORDER**

1           **RELEASED ON AUGUST 8, 1996 IN CONJUNCTION WITH THE ACT?**

2

3    A.    Yes.

4

5    Q.    **WHAT IS THE IMPACT OF THE ORDER ON AT&T'S POSITION ON**  
6           **AVOIDED COSTS AND WHOLESALE PRICING?**

7

8    A.    Generally, the Order is supportive of AT&T's approach to determining avoided  
9           costs. At this time, AT&T is in the process of thoroughly analyzing the Order and  
10          testimony could be supplemented where appropriate.

11

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

14

15   A.    Yes. AT&T recommends that wholesale rates for GTE's services subject to resale  
16          be based upon a minimum avoided retail cost percentage of 30.9%. In support of  
17          this percentage reduction, AT&T has presented as Exhibits AL-4 and AL-5, a  
18          summary and a supporting cost study of GTE's costs that will be avoided when GTE  
19          provides local services on a wholesale basis. The direct retail costs that GTE will  
20          avoid include all billing costs, collection costs, costs pertaining to operator functions  
21          and systems, marketing, advertising, and uncollectibles. GTE, also, will avoid  
22          indirect retail costs, such as those related to General & Administrative expenses and  
23          costs resulting from support assets used in performing the retailing function.

24

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

1

2 A. Yes, it does.



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

**Docket No. 960847-TP**

**Filed: September 24, 1996**

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

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

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

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

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

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

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

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

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

8  
9 I will respond to the direct testimony of GTE witness Douglas E. Wellemeyer.  
10 Specifically I will address GTE's Avoided Cost Study ("Original Study") discussed  
11 by Mr. Wellemeyer in his testimony. I will also address GTE's Modified Avoided  
12 Cost Study ("Modified Study") which was also discussed in his testimony. Mr.  
13 Wellemeyer states that the Modified Study was prepared by GTE "in conformance  
14 with Part 51 Rules, for use if the Rules are determined to be lawful."

15

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

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

22

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

1

2 2. "an avoided cost study must include indirect, or shared, costs as well as direct  
3 costs." FCC Order, ¶ 912;

4

5 3. "[a] portion of contribution, profits, or markup may also be considered  
6 'attributable to costs that will be avoided' when services are sold wholesale."  
7 FCC Order, ¶ 913;

8

9 4. "[a]n avoided cost study may not calculate avoided costs based on non-cost  
10 factors or policy arguments." FCC Order, ¶ 914;

11

12 5. "precludes use of a 'bottom up' TSLRIC study to establish wholesale rates that  
13 are not related to the rates for the underlying retail services." FCC Order,  
14 ¶ 915;

15

16 6. "[w]e neither prohibit nor require use of a single, uniform discount rate for all  
17 of an incumbent LEC's services." FCC Order, ¶ 916;

18

19 7. According to the FCC Order, the direct costs in the following Uniform System  
20 of Accounts ("USOA") accounts are presumed avoidable:

21

- 6611-product management

22

- 6612-sales

23

- 6613-product advertising

24

- 6621-call completion services

25

- 6622-number services (also referred to as directory assistance)

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

2

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

6

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

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

13

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

18

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

22

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

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

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

3

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

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

8

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

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

16

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

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

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

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

2

3

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10

11

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

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

21

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

24 A. All USOA accounts that are presumed avoided in the FCC's Order (FCC Order,  
25 ¶¶ 917, 918) are reflected. Also included is an amount of avoided costs pertaining to

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

9  
10 **Q. PLEASE EXPLAIN WHAT AVOIDED COSTS, IF ANY, ARE INCLUDED**  
11 **IN THE ASAC STUDIES THAT WERE NOT SPECIFICALLY PRESUMED**  
12 **AVOIDED IN THE FCC ORDER AND RULE.**

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

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

24

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

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

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

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

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



1           **AVOIDABLE COSTS?**

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

21

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

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

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

8

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

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

21

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

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

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

3

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

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

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

19

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

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

6

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

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

11

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

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

20

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

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

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

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

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

15  
16 **Q. WHAT, IF ANY, CONCERNS DO YOU HAVE WITH GTE'S ORIGINAL**  
17 **AVOIDED COST STUDY?**

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

23  
24 **Q. IS THERE ANY SIGNIFICANCE TO USING THIS NATIONAL RETAIL**  
25 **COST DATA TO CALCULATE GTE'S AVOIDED COSTS FOR FLORIDA?**

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

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

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

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

1

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

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

17

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

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

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

11

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

20

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

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



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

7

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

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

21

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

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

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

8

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

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

20

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

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

1

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

5 **A.** Available and readily verifiable cost data in the avoided cost study filed by AT&T in  
6 this proceeding support a retail cost reduction well above the maximum default rate of  
7 25%. The FCC Order authorizes states to establish interim wholesale discounts  
8 within a default range of 17-25%. I would recommend an interim retail cost  
9 reduction at the highest end of that range--a 25% interim cost reduction.

10

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

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

19

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

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

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

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

4 **A. Yes it does.**

1 BY MS. DUNSON:

2 Q Mr. Lerma, did you also prepare five exhibits  
3 which were attached to your direct testimony?

4 A Yes, I did.

5 Q Do you have any changes or corrections to make to  
6 these exhibits?

7 A No, I do not.

8 MS. DUNSON: Madam Chairman, I also request that  
9 Mr. Lerma's Exhibits AL-1 through AL-5 be marked for  
10 identification.

11 CHAIRMAN CLARK: They will be marked as Composite  
12 Exhibit 13.

13 (Composite Exhibit Number 13 marked for  
14 identification.)

15 BY MS. DUNSON:

16 Q Mr. Lerma, did you also cause to be prepared  
17 rebuttal testimony with 20 pages which was prefiled on  
18 behalf of AT&T in this proceeding on September 24th, 1996?

19 A Yes, I did.

20 Q Do you have any changes or corrections to make to  
21 your rebuttal testimony?

22 A Yes, I do.

23 Q Would you please identify those?

24 A Yes. On Page 13 of my testimony, on Line 20,  
25 where it says BellSouth there, BellSouth's Florida

1 residential should be GTE's. And only one other point that  
2 I would like to bring to the Commissioners' attention. On  
3 Page 19 of my testimony, I believe it's the next to the last  
4 -- it's a question and answer that begins on Line 20 of  
5 Page 19, states, "Have you reviewed the Florida-specific GTE  
6 cost studies that Mr. Wellemeier references in his  
7 testimony." I stated no. At the time that I prepared this  
8 testimony, I had not yet received the specific Florida  
9 studies. I had performed my review based on Texas-specific  
10 studies that I had an opportunity to review. I did review  
11 the Florida studies the next day after I prepared this  
12 testimony, and I had no further changes to make to my  
13 testimony. And I just wanted to bring that to the attention  
14 of the Commissioners.

15 Q Are those all of your corrections?

16 A Yes, they are.

17 Q So if I asked you the same questions today as are  
18 contained in your prefiled rebuttal testimony with the  
19 corrections that you have just identified, would your  
20 answers be the same?

21 A Yes, they would.

22 MS. DUNSON: Madam Chairman, I also request that  
23 Mr. Lerma's rebuttal testimony be inserted into the record  
24 as though record.

25 CHAIRMAN CLARK: It will be inserted in the record

1 as though read.

2 BY MS. DUNSON:

3 Q Mr. Lerma, did you also prepare three exhibits  
4 which were attached to your rebuttal testimony?

5 A Yes, I did.

6 Q Do you have any changes or corrections to make to  
7 these exhibits?

8 A No, I do not.

9 MS. DUNSON: Madam Chairman, I request that Mr.  
10 Lerma's Exhibits ALR-1 through ALR-3 be marked for  
11 identification.

12 CHAIRMAN CLARK: They will be marked as Exhibit  
13 14.

14 (Exhibit Number 14 marked for identification.)

15 BY MS. DUNSON:

16 Q Mr. Lerma, did you prepare a summary of your  
17 testimony?

18 A Yes, I did.

19 Q Would you please give it for the record?

20 A Yes, I will. Good evening, Commissioners. Per  
21 the Telecommunications Act of 1996, wholesale rates offered  
22 by GTE to AT&T for services subject to resale shall be based  
23 on retail rates less costs for avoided retail functions no  
24 longer performed by GTE in a wholesale environment. In my  
25 direct testimony, I provide my opinion regarding the

1 requirements of the act with respect to GTE wholesale rates  
2 for services subject to resale. At that time I provided an  
3 AT&T avoided cost study compliant with the act that produced  
4 an avoided retail cost percentage reduction of 30.9 percent  
5 applicable only to GTE local service rates. In my rebuttal  
6 testimony, I present AT&T's simplified avoided cost study in  
7 response to the cost study submitted by GTE which produced  
8 unreasonably low percentage reductions applicable to GTE  
9 retail rates. This study also complies with the act, and is  
10 further consistent with the FCC's order and rules released  
11 August the 8th, 1996. The study produces a uniform  
12 percentage reduction of 36.15 percent applicable to all GTE  
13 local, toll, and private line rates, and is a percentage  
14 reduction now recommended by AT&T.

15 This specific chart that is being put over here I  
16 have developed for illustrative purposes to demonstrate how  
17 this percentage is calculated. Beginning in the first  
18 column that is labeled 1995 regulated amounts, ARMIS 4303,  
19 those are the specific booked amounts on the 4303 reports  
20 that are submitted by GTE to the FCC under ARMIS, and ARMIS  
21 stands for Automated Reports Management Information Systems.  
22 These are booked accounts and booked amounts, and that is  
23 what is reflected in the first column. And those happen to  
24 be the categories of accounts that AT&T has determined  
25 include directly avoided costs and indirectly avoided costs.



1 If we move over to the middle column labeled AT&T simplified  
2 avoided cost study, that column provides those amounts that  
3 AT&T's study has calculated as directly avoided and  
4 indirectly avoided. You will note that there is a grand  
5 total of \$154,948,000 in directly avoided costs, there are  
6 \$96,859,000 in total indirectly avoided costs, giving you a  
7 total avoided cost of 251,807,000. If you divide those by  
8 the revenues subject to resale that appear there of 696,472,  
9 that produces the 36.15 percent. The last column that I put  
10 there is basically for informational purposes. It gives you  
11 the specific portion that each individual line represents of  
12 the 36.15 percent. For example, if you look at the very  
13 first line up there, product management, 6611, if we were to  
14 take the 6370 that is identified there as an avoided cost  
15 and divide that by the revenues subject to discount at the  
16 bottom of that column, you would get the .91 percent that  
17 appears there. So that's the individual component for that  
18 specific line.

19 In my rebuttal testimony, I also respond to the  
20 direct testimony of GTE Witness Douglas E. Wellemeyer. My  
21 review and analysis of the GTE cost studies presented by Mr.  
22 Wellemeyer demonstrates the insufficiency of the percentage  
23 of avoided cost calculated for each account by GTE. The  
24 avoided cost study that GTE recommends be used to set  
25 wholesale rates produces separate avoided cost calculations

1 and rates for five general service categories; residence  
2 local service, business local service, usage services,  
3 vertical services, and advanced services. The composite of  
4 these five services is an avoided cost percentage of only 7  
5 percent. This is significantly lower than even the interim  
6 default range of 17 to 25 percent recommended by the FCC for  
7 use when compliance studies are not available for use in  
8 setting permanent wholesale rates, and significantly lower  
9 than the percentage reduction recommended just last week by  
10 BellSouth when they recommended in their cost study that the  
11 percentage reduction for residence was over 19 percent.

12           Now some of the more significant problems that I  
13 have with this study are, number one, that this is a  
14 national work center study that may not be representative of  
15 state-specific costs used to set GTE's rates in Florida.  
16 Number two, GTE's study produces small percentages of  
17 avoided costs or none at all for categories that the FCC  
18 presumed were completely avoided, and GTE also included no  
19 avoided indirect costs, such as general administrative and  
20 corporate operations costs. Number three, GTE recommends  
21 that local wholesale rates be further artificially increased  
22 by the net impact of potential lost intraLATA toll revenues  
23 and access revenues gained. And, number four, GTE, as  
24 mentioned previously, excludes numerous categories of  
25 services from being subject to resale, including what GTE

1 refers to as below cost services, promotional services,  
2 discounted calling plans, AIN services, and all payphone  
3 services. GTE -- before I go on, I might mention also, too,  
4 last week if you recall, I had another chart up here where I  
5 had AT&T's cost study lined up with BellSouth's, and I was  
6 able to demonstrate to you --

7 MR. GILLMAN: I object. He is talking about last  
8 weeks testimony. This is not part of his testimony and he  
9 shouldn't be allowed to talk about it.

10 CHAIRMAN CLARK: I agree. You need to confine  
11 your summary to the testimony that you have presented by  
12 prefiling.

13 WITNESS LERMA: Yes, I will. GTE also produces a  
14 modified study that purportedly conforms to the FCC criteria  
15 for cost studies. This alternative study produces a  
16 percentage reduction of 11.25 percent. It too suffers from  
17 many of the same problems that are inherent with their  
18 original study in that it primarily utilizes cost data from  
19 the same national work center analysis.

20 The price that resalers pay for GTE's wholesale  
21 services will determine the likelihood that Florida  
22 consumers will have local services choices now at  
23 competitive prices. This specific chart that is being put  
24 up right now demonstrates this. Resalers should not have to  
25 bear the incumbent LEC's retail costs. And just to

1 demonstrate this, on the left there where it says the total  
2 price to the customer today offered by the incumbent LEC, in  
3 this case GTE, includes not only wholesale costs, but retail  
4 costs. Those are the costs that we are trying to identify  
5 today and that we are determined to identify so we can  
6 determine which costs will be avoided. On the right is the  
7 price that would be offered by the resaler to the customer.  
8 If we don't identify all of those retail costs on the left  
9 as avoided, they will be included in that price offered to  
10 the customer. It will include not only recovery of the  
11 resalers retail costs, it will include recovery of GTE's  
12 retail costs and its wholesale costs, and obviously the  
13 price will be higher.

14           Setting the appropriate wholesale rate will make  
15 as many services as possible available. Essentially,  
16 consumers will be the winners and receive greater value  
17 while resalers will establish a viable presence in the local  
18 exchange marketplace. How can we ensure that wholesale  
19 rates are appropriately set? The Telecommunications Act of  
20 1996 provides the guidance necessary, and the FCC order and  
21 rules provide the consistent criteria necessary for doing  
22 this. Avoided retail costs must be identified and retail  
23 rates reduced. Paragraph 911 of the FCC order and rules  
24 concludes that the relevant retail related costs are those  
25 costs that would be avoided in maintaining a retail as

1     opposed to a wholesale business.

2             So, specifically what action is requested by this  
3     Commission? AT&T requests that this Commission use the AT&T  
4     simplified avoided cost study to set wholesale rates for  
5     resale services and adopt a single statewide wholesale  
6     discount of 36.15 percent.

7             In closing, an appropriate wholesale rate will  
8     enhance the speed at which more innovative services will  
9     become available bringing greater value to consumers in  
10    Florida.

11   BY MS. DUNSON:

12            Q     Does that conclude your summary?

13            A     Yes, it does.

14            MS. DUNSON: The witness is available for cross  
15    examination.

16            CHAIRMAN CLARK: Mr. Melson.

17            MR. MELSON: Just you a couple of questions.

18                            CROSS EXAMINATION

19   BY MR. MELSON:

20            Q     Mr. Lerma, I'm Rick Melson representing MCI. You  
21    are aware, are you not, that MCI has taken a slightly  
22    different approach to an avoided cost study than AT&T has  
23    taken?

24            A     Yes, I understand.

25            Q     If I wanted to compare AT&T's cost study to GTE's

1 cost study, do you have a chart that compares your numbers  
2 to GTE's?

3 A No. I was not able to do that, because GTE  
4 provided as backup to all of its avoided cost percentages  
5 that are included in its testimony, the backup that was  
6 provided was provided entirely as proprietary, and that  
7 included not only the cost center information, the  
8 information that is specifically ARMIS based, even the  
9 glossary with explanations as to what each of the individual  
10 cost centers was entirely done as proprietary, so that's the  
11 reason I was not able to do that.

12 MR. MELSON: Well, without that, I don't have a  
13 basis for further questions. Thank you.

14 CHAIRMAN CLARK: Mr. Gillman.

15 MR. GILLMAN: Yes. Thank you, Chairman Clark.

16 CROSS EXAMINATION

17 BY MR. GILLMAN:

18 Q Mr. Lerma, the only data that you relied upon in  
19 either one of these studies that you are proposing was the  
20 Florida ARMIS data, is that correct?

21 A I'm sorry, would you rephrase that again. I'm not  
22 sure I understood the question.

23 Q The only data that you rely upon in conducting  
24 either one of the studies that you have put forward for the  
25 Commission is the ARMIS data, is that correct?

1           A     No, that's incorrect.

2           Q     What other analysis have you done regarding GTE's  
3 cost of retail, other than looking at the ARMIS data?

4           A     Well, specifically, the AT&T simplified cost study  
5 uses the ARMIS data as input, but AT&T did specifically go  
6 through each of the accounts, and in terms of compliance  
7 with the act, I specified in the direct testimony what the  
8 act specified as a requirement for what is considered an  
9 avoided cost. So basically it's based on compliance with  
10 the act in addition to the consistent application of the  
11 rules and the FCC order.

12          Q     The numbers that you use reflecting GTE's costs  
13 that you contend are avoided were taken directly off the  
14 ARMIS accounts, were they not?

15          A     Yes, they were. That's the input.

16          Q     You have not attempted to conduct any sort of  
17 GTE-specific studies of actual costs that might be avoided  
18 by GTE, have you?

19          A     No, I have not. But, however, I have reviewed the  
20 cost studies that GTE has provided both in Florida and in  
21 several other states now. And so based on that information,  
22 I feel reasonably comfortable that it corroborates what I  
23 put together as an AT&T study.

24          Q     GTE's study corroborates your study?

25          A     It corroborates the fact that I feel comfortable

1 that AT&T's -- that AT&T's discount is the correct one.

2 Q Now, in your answer to Mr. Melson, you refer to  
3 the fact that GTE has claimed this to be proprietary. You  
4 have reviewed the cost study, have you not?

5 A Yes, I have.

6 Q Okay. Now, the FCC has made certain presumptions  
7 regarding avoided costs, has it not?

8 A Yes, with respect to the order and rules.

9 Q And more specifically, the FCC has presumed that a  
10 certain percentage of cost would be avoided by ARMIS  
11 account, correct?

12 A That's correct.

13 Q And in some of those accounts, the FCC presumed  
14 100 percent and other accounts they presumed 90 percent?

15 A No, that is incorrect.

16 Q What part of that statement was incorrect?

17 A That assumption with regard to 100 percent and 90  
18 percent was strictly with respect to how they went about  
19 setting proxy rates. With respect to the actual rules and  
20 the criteria for cost studies, there were presumptions that  
21 certain accounts were completely avoided. There was no  
22 reference to the 90 percent in the rules, only with respect  
23 to how proxy interim default rates were calculated.

24 Q And it's your contention that the 100 percent  
25 presumption was not reflected in the proxy rates, as well?



1           A     No. In the calculation of the interim default  
2 range, there were four specific accounts that the FCC used a  
3 presumption of 90 percent avoided, but only for the purpose  
4 of calculating the interim default range. That specific  
5 reference is not included in the actual rules.

6           Q     Can you give me that specific reference to the  
7 FCC?

8           A     Yes, I can. If you would look at Paragraph -- I  
9 believe it's 928, the specific reference there is dealing  
10 with an adjustment that was made to MCI's --

11          Q     Could you give me a second?

12          A     Yes.

13          Q     Okay.

14          A     In Paragraph 928 there is a reference there made  
15 to an adjustment made to the MCI model in calculating --  
16 this section, by the way, is in a section labeled default  
17 range of wholesale discount rates. And in that paragraph,  
18 right near the end of that paragraph on the next page, it  
19 states, "Given the lack of evidence and the wide range of  
20 estimates that have been made by these states, we find it  
21 reasonable to assume for purposes of determining a default  
22 range of wholesale discount range that 10 percent of the  
23 costs in Account 6611, 6612, 13, and 23 are not avoided by  
24 selling services at wholesale." That's where the issue of  
25 the 90 percent comes in. It's the only place where that

1 reference is made.

2 Q In any event, AT&T assumed 100 percent on all of  
3 those accounts, did they not?

4 A Yes, as did the FCC in rules.

5 Q Now, these ARMIS data, that includes embedded  
6 costs, does it not?

7 A Yes.

8 Q Or otherwise referred as accounting costs?

9 A That's one of the terms I have heard.

10 Q And they wouldn't in any way, or any shape or form  
11 reflect long-run incremental costs, would they?

12 A No, and that would be inappropriate to even  
13 consider long-run incremental costs in the determination of  
14 avoided costs.

15 Q I understand, I'm just asking you the question.  
16 And it also doesn't include -- or it does include all joint  
17 and common costs that would relate to the retail activities  
18 allegedly avoided, is that correct?

19 A I'm sorry, what would include?

20 Q The ARMIS data also includes those joints and  
21 common costs that are attributable to the retail functions  
22 avoided?

23 A Yes.

24 Q Another way to refer to these are historical costs  
25 that are being avoided?

1           A     Yes, that's correct. It's the same costs that  
2 were used to set rates.

3           Q     Now, what specific studies has AT&T relied upon to  
4 assume that these various accounts will be 100 percent  
5 avoided?

6           A     What specific study?

7           Q     Yes.

8           A     AT&T's study relies on complying with the act, the  
9 description in the act that specifies what accounts will be  
10 avoided, and then the FCC order and rules -- the FCC order  
11 provides the rules for doing that.

12          Q     Okay. So you're relying solely on the FCC rule to  
13 assume that 100 percent of these costs will be avoided?

14          A     No, that's not what I said. I said, first of all,  
15 that it complies with the act. And the act specifically  
16 gives the language for the accounts or the types of expenses  
17 that will be avoided. The FCC order and rules says that  
18 presumptively these accounts will be avoided and that's  
19 specifically what AT&T has done.

20          Q     And what study, if any, have you relied upon to  
21 justify that 100 percent as opposed to 50 percent or 25  
22 percent or 5 percent would be reasonably avoided by GTE?

23          A     Well, it's my understanding that the FCC order and  
24 rules categorize those accounts as presumptively avoided and  
25 it is the LEC's responsibility to rebut that presumption.

1 Q Okay. So the answer to the question is you are  
2 not relying on any studies, are you?

3 A I'm relying on whatever GTE provides that I have  
4 an opportunity to review.

5 Q Okay. Let's take the product management account.  
6 You assumed that all product management expenses would be  
7 avoided, is that correct?

8 A That's correct.

9 Q And, in fact, you know, with your analysis in  
10 general, you're assuming that GTE will get completely out of  
11 the retail business, are you not?

12 A The basis that -- yes. The basis that I have used  
13 that underlies the AT&T simplified avoided cost study is  
14 that GTE will be providing its services in a wholesale  
15 environment.

16 Q And not providing any services in a retail  
17 environment?

18 A That's correct.

19 Q And, of course, that is not true, is it?

20 A No. What specifically will be taking place is  
21 that GTE will have a separate retail service at the same  
22 time that it is providing wholesale service, but by  
23 specifically using and calculating rates based on a  
24 wholesale environment, then essentially the rate offered to  
25 that individual customer reflects that environment. It's a

1 pricing issue that deals with the fact that from a pricing  
2 standpoint you are only -- you are only reflecting those  
3 costs that are included and necessary in a wholesale  
4 environment.

5 Q Going back to the product management account, and  
6 you assumed the 100 percent. Now, this product management  
7 cost account would include costs for product development,  
8 would it not?

9 A It's my understanding that's probably one of the  
10 categories that would be included.

11 Q So if there were costs that GTE incurred in  
12 designing or inventing a new service, I mean, that would be  
13 included under product development, wouldn't you agree?

14 A It would be included, but not at the level that is  
15 included in that account today. And what is included in  
16 that account today are retail costs related to product  
17 development, not wholesale.

18 Q It would be included in that account, would it  
19 not?

20 A To the extent that any costs in a wholesale  
21 environment would be reflected for product development, that  
22 is the account that they would be included in.

23 Q I think we may be on different tracks here. In  
24 the ARMIS study, in the ARMIS account for product  
25 management, what account is that, 6623?

1           A     For product management, 6611.

2           Q     6611. Account Number 6611 includes things such as  
3 product development and product rollout of GTE's retail  
4 services, does it not?

5           A     Yes, that's what it includes from a retail  
6 perspective.

7           Q     And, I mean, because if GTE comes out with a  
8 service, they are going to have to spend some costs to see  
9 if the service works, they are going to determine whether  
10 the company can maintain it or support it, wouldn't you  
11 agree?

12          A     Yes. However, based on just what you just  
13 finished saying, you are saying it's based on what they are  
14 going to expect once they roll things out, and what we are  
15 talking about is from a wholesale perspective that hasn't  
16 happened yet. And we can't make the assumption that because  
17 there is costs today that are being incurred in a retail  
18 environment for product management, that those will be the  
19 same level of costs that will be incurred in a wholesale  
20 environment.

21          Q     But won't these same costs be incurred in a  
22 wholesale environment?

23          A     No, I disagree with that.

24          Q     So, AT&T is going to develop a product that we are  
25 going to resale?

1           A     AT&T and other resalers will have their own  
2 product development costs for rolling out the specific  
3 products that it will be rolling out on a resale basis.

4           Q     But that will be AT&T's service, that won't be a  
5 resold GTE service, will it?

6           A     Yes, that will be AT&T's service.

7           Q     So you're not buying resold services from GTE in  
8 that instance, are you?

9           A     No. But I think what we are missing here is that  
10 the costs -- we can't rely on the costs that are booked to  
11 Account 6611 today as product management to be an indicator  
12 of what is going to be spent, if at all, for product  
13 management on a going-forward basis in a wholesale  
14 environment. That's the information that I was looking for  
15 Mr. Wellemeyer to put forward in this case, and the only  
16 thing I have gotten is that because there are descriptions  
17 of functions that might be produced in a wholesale  
18 environment, then we should accept that that's the level  
19 that will be incurred in a wholesale environment.

20          Q     Is it your testimony that a wholesaler would never  
21 incur product management expenses?

22          A     No, that is not my testimony.

23          Q     So a wholesaler will incur and spend costs for  
24 product development, would they not?

25          A     Yes, more than likely.

1 Q And a wholesaler would incur costs for rolling out  
2 a new product for resale on a wholesale basis?

3 A I think it conceivably will incur some costs  
4 probably at a different level than it incurs today on a  
5 retail basis.

6 Q I mean, they will still have to train their  
7 employees to support that product even on a wholesale basis,  
8 won't they?

9 A It's possible, yes.

10 Q They will still have an order entry system for  
11 purchases of the wholesale product -- purchase a wholesale  
12 product -- you can tell it's getting late in the day. They  
13 would order entry systems for ordering or selling wholesale  
14 products, would they not?

15 A Yes. However, as I stated previously, all of  
16 these are based on what would be required in a wholesale  
17 environment and may be totally different from what is being  
18 experienced today.

19 Q I understand. But aren't you saying that there  
20 are no wholesale costs that GTE -- no costs under Account  
21 6611 that GTE will incur on a wholesale basis?

22 A I have -- yes. The way I have calculated it is  
23 based on the fact that it is presumptively avoided, and I  
24 have been looking for GTE to rebut that presumption and  
25 provide me -- provide AT&T and the resalers information



1 regarding what it's going to cost to provide product  
2 management in a wholesale environment.

3 Q Why is GTE any different from any other  
4 wholesaler? Why wouldn't GTE as a wholesaler have an order  
5 entry system and be required to train their staff to support  
6 wholesale services?

7 A I never said GTE would be different.

8 Q So GTE will have those expenses and those expenses  
9 will not be avoided even though they sell it on a wholesale  
10 basis?

11 A I disagree. When you say they are not going to be  
12 avoided, the assumption being made there is that the level  
13 of product management cost that is incurred today will be  
14 the same level that would be incurred on a going-forward  
15 basis, and we don't have any information to make that  
16 conclusion.

17 CHAIRMAN CLARK: Mr. Gillman, I've heard this line  
18 of questioning for a long time now.

19 MR. GILLMAN: Thank you. Keep me straight.

20 BY MR. GILLMAN:

21 Q Can we go to the Account Number 6533. And maybe  
22 let's look at either one of your studies. By the way, is it  
23 your testimony that you're -- let me think of the word --  
24 trashing your first study, the second study is the one that  
25 applies now?

1           A     The second study is the study that AT&T is using  
2 to base its recommendation on.

3           Q     Although I would like to look at the other one  
4 because I think it's -- let's look at Lerma Exhibit AL-4.

5           A     All right.

6           Q     And specifically Line 6 for operations testing.

7           A     Yes.

8           Q     Now, GTE presently conducts this testing as part  
9 of its retail services, is that correct?

10          A     Yes.

11          Q     I should have asked what are you referring to here  
12 when you're talking about operations testing?

13          A     Well, let me mention specifically, you know, what  
14 this is. And it requires specifically understanding what is  
15 booked today to Account 6533. And based on the Part 32  
16 definition of Account 6533, in the testing account, not only  
17 do you include the actual costs of testing equipment, but  
18 you also include the costs of when a customer calls in and  
19 has a trouble report, you include the cost of receiving and  
20 recording the call, of the preliminary trouble analysis, and  
21 when I say preliminary trouble analysis, with the service  
22 trouble reporting data base interface that AT&T will have  
23 with GTE, it will be able to perform isolation testing.  
24 When it does isolation testing, when a customer calls in it  
25 will be able to tell that customer -- determine whether the

1 problem is on his premises or in the GTE central office. At  
2 that point, if we make the determination that it is on the  
3 customer's premises, we don't even have to forward that  
4 information to GTE. If it is in the central office, then  
5 that information will be forwarded to GTE so the repair  
6 additional testing can be done. It is those functions, the  
7 customer interface functions that I'm referring to. The  
8 receiving, the recording, isolation testing, the provision  
9 of status to the customer to let him know, you know, how  
10 it's going with fixing his account. Those costs are booked  
11 in that account along with all other testing costs. And so  
12 the 20 percent that is reflected here is the portion of the  
13 costs in that account that AT&T believes pertain to that  
14 customer interface that will be performed by AT&T and the  
15 resalers.

16 Q So is it your testimony that GTE should provide a  
17 resold, say, B-1 service without this testing provided?

18 A No, that's not my testimony. That's not what I  
19 said.

20 Q Okay. If GTE is to provide a resold B-1 service  
21 with the testing, then these costs would not be avoided?

22 A No, that's incorrect. Because as I specifically  
23 said awhile ago, from a convenience standpoint going forward  
24 it would be inappropriate if we resold a service to a  
25 customer and then said, "Now, if you have trouble with that

1 service, don't call us, call GTE and let them know that  
2 you've got problems." They are going to call us to report  
3 that problem and it is those costs that I'm referring to  
4 that AT&T or the resalers will incur in receiving and  
5 recording and performing that initial testing. I am not  
6 indicating at all whatsoever that GTE will stop performing  
7 additional testing necessary when the problem is in the  
8 central office, performing the repair work, that will still  
9 continue. And AT&T and the resalers will notify GTE when  
10 that is necessary.

11 Q Okay. And you haven't excluded those costs?

12 A I have only excluded the customer interface  
13 portion of the costs that are included in that account.

14 Q And how was that number determined?

15 A AT&T, based on its own experience, looked at the  
16 amounts that AT&T books in Account 6533, and from that we  
17 are able to determine what portion of that is customer  
18 initiated. From AT&T's experience, over 50 percent of the  
19 costs included in the testing account are customer-initiated  
20 testing costs. The 20 percent is a conservative estimate.

21 Q I guess I still don't -- when you say  
22 customer-initiated testing costs, I mean, that means when a  
23 customer complains about their service and then the company  
24 tests the line, is that what you're talking about?

25 A Yes. Essentially, there is also what you call

1 background testing that is conducted or routine testing that  
2 is conducted whether a customer calls in or not. But the  
3 predominate amount of testing is related to a customer  
4 calling in and complaining that he has got problems on his  
5 line. So it's that customer-initiated portion of the  
6 amounts booked in the testing that I am referring to.

7 Q I mean, how did you determine the amount of, the  
8 percentage of when a customer complains, the percentage of  
9 times it's going to be in part of GTE's network where GTE  
10 would have to do some additional testing at the request of  
11 AT&T?

12 A I'm sorry, I didn't quite understand the question.

13 Q How did you determine the percentage of times that  
14 AT&T would then go to GTE to ask for additional testing to  
15 discover what the problem is?

16 A I didn't. I have an estimate as to what  
17 percentage of the costs included in testing to date deal  
18 with the customer interface, and presumptively the other 80  
19 percent would not involve customer interface.

20 Q I guess I thought your test of the 50 percent,  
21 that was whether an end user customer complained or another  
22 customer. Was that not true? Where did the 50 percent come  
23 from?

24 A The 50 percent is, as I stated previously, the  
25 portion of the costs booked in the testing account that were

1 initiated when a customer called in and complained about a  
2 problem with his line. And that generated the whole process  
3 of testing, and that portion is what we call the  
4 customer-initiated portion. Any other costs in there that  
5 are not customer-initiated are just part of the routine  
6 testing that is done whether a customer is calling in or  
7 not.

8 Q Account Number 6623, that's customer services, is  
9 it not?

10 A Yes.

11 Q And these accounts include carrier access costs,  
12 do they not?

13 A Yes, they do.

14 Q And if I understand the difference between your  
15 two studies, you didn't include them in the first study, but  
16 you excluded those costs out on your second study?

17 A Well, the primary difference is that in the first  
18 in study it was a study based solely on local costs, and  
19 this study looks at all costs. So it's necessary to look at  
20 what portion of those costs involve avoided retailing costs,  
21 and that's why we have a calculation to remove the portion  
22 of directly avoided costs that pertains to the provision of  
23 access.

24 Q Does this customer service category also include  
25 costs to serve cellular carriers?

1           A     To the extent that there are such costs, it would.

2           Q     Okay. Have these been excluded from your  
3 analysis?

4           A     I don't know. Access is specifically excluded and  
5 then we have a category of costs related to miscellaneous  
6 costs that underlie miscellaneous revenues, and to the  
7 extent that the costs for cellular are included in the  
8 miscellaneous category, they would be included. I don't  
9 know specifically.

10          Q     You don't know?

11          A     I can't answer that.

12          Q     Now, are you proposing to apply this discount  
13 across all services that GTE sells?

14          A     Yes. It would be applicable to all services  
15 subject to resale on a uniform basis.

16          Q     Even though the actual retail costs may vary from  
17 service to service or type of service to type of service?

18          A     Yes. But that's taken into account in the way the  
19 discount is put together.

20          Q     Also, it would apply regardless of the cost of the  
21 service, the percent would apply if the service costs \$100  
22 or \$10, would it not, the same percentage?

23          A     It applies uniformly to the retail rates. It  
24 makes no difference what the cost of the service is because  
25 there is no difference in what is happening. We are

1 calculating a discount that takes into consideration costs  
2 that would be avoided. The rates are reduced and it's a  
3 wash, so it has nothing to do with the cost of the service.

4 Q Well, you're not really assuming any economies of  
5 scale, are you?

6 A I don't understand your question.

7 Q Well, if a customer buys \$100 worth of services,  
8 and it costs the company the same amount of retail expense  
9 to sell that \$100 of services as it does to sell \$10 of  
10 services to another customer, the percentage of retail cost  
11 between those two customers would be different, would they  
12 not?

13 A Yes, it would. But it would have no -- it  
14 wouldn't at all be related to what we are talking about  
15 here, because that's a forward-looking item, and what we are  
16 talking about here is adjusting retail rates based on costs  
17 that underlie how those rates were set. And what we are  
18 talking about here is future economies of scale that you're  
19 talking about.

20 Q The discount would be applied on a going-forward  
21 basis, would it not?

22 A Yes.

23 Q Now, Mr. Lerma, kind of some logistics here. On  
24 Page 6, Lines 18 and 19, you refer to Page 2 of your  
25 Exhibit ALR-2?



1           A     Yes.

2           Q     And on Line 8 of that same page, you refer to  
3 Page 3 of ALR-2?

4           A     Yes.

5           Q     And on Page 10, Line 20, you refer to Page 4 of  
6 ALR-2?

7           A     Yes, I do.

8           Q     And my ALR-2 shows only one page and it says  
9 Page 1 of 1.

10          A     I don't know how that happened. It's supposed to  
11 be a four-page exhibit. Page 1 of 4, 2 of 4, 3 of 4, and  
12 4 of 4.

13                   COMMISSIONER KIESLING: If it's any help, that's  
14 what mine looks like, too.

15                   WITNESS LERMA: I'm sorry?

16                   COMMISSIONER KIESLING: Mine only has one page.  
17 It says 1 of 1.

18                   WITNESS LERMA: I don't know what happened. It  
19 should be a four-page exhibit.

20                   MR. HATCH: Apparently it was an error in filing.  
21 We can get you the four pages.

22                   CHAIRMAN CLARK: Why don't you do that.

23                   MR. HATCH: I may have to borrow Mr. Lerma's. It  
24 will take a few minutes, if you want to take a break or if  
25 you want to proceed, either way.

1 MR. GILLMAN: I'm willing to go forward.

2 CHAIRMAN CLARK: Do you have more questioning?

3 MR. GILLMAN: Yes.

4 CHAIRMAN CLARK: Go ahead.

5 BY MR. GILLMAN:

6 Q I want to talk about -- before we talk about the  
7 studies, operator services. Now you have excluded, again,  
8 100 percent of GTE's operator services expense, have you  
9 not, in your study?

10 A Yes, I have.

11 Q Now, operator service is a separate service that  
12 has separate tariffed rates, does it not?

13 A Operator services has some separate rates.

14 Q Okay. Also, directory assistance has separate  
15 rates, does it not?

16 A It has separate rates, however, there are costs  
17 related to directory assistance related to the free call  
18 allowance, the free calls that are embedded in resale rates.  
19 And so, therefore, there are retail rates in addition to  
20 those that also recover operator services costs.

21 Q And would you agree with me that the cost of  
22 operator services and directory assistance is recovered  
23 within the -- or expenses of those two services are  
24 recovered within the rates of those services?

25 A No, I would disagree with that. Those are rates

1 that have been established, but I'm not aware of any time  
2 that there was a revenue requirement case that established  
3 what the embedded costs of operator services were and that  
4 those rates were cost-based. There are rates that at some  
5 time during the course of rate cases that have taken place  
6 here have been established to help recover parts of the  
7 entire revenue requirement for GTE that were submitted  
8 whenever that was taking place, but I'm not aware that  
9 operator services rates are cost-based at this point.

10 Q I guess you're saying you don't know whether they  
11 recover their costs fully, but those rates that are charged  
12 for operator services and directory assistance are designed  
13 to recover the expenses GTE incurs in providing those  
14 services, correct?

15 A Yes, in part. Because those rates, although they  
16 are identified as being operator services rates, when they  
17 are set they are set just in the same way that rates for  
18 vertical services are set. If you decide that you are going  
19 to set a rate for call waiting, there was never a specific  
20 revenue requirement to determine that those are the specific  
21 costs needed for call waiting. It was just a rate that was  
22 determined. And that rate recovered some revenues and it  
23 went toward recovery of the entire intrastate revenue  
24 requirement, and that is the same process that is used for  
25 developing operator services rates.

1           Q     Okay, Mr. Lerma. I want to ask you to assume,  
2 because we can put cost testimony on, that the expenses for  
3 operator services and directory services are recovered from  
4 those specific rates and they are not recovered from the  
5 retail rate for, say, B-1 or R-1 service. Now, can you  
6 assume that with me? Are you willing to make that  
7 assumption for the purpose of the questioning?

8           A     Yes, hypothetically I will make that assumption.

9           Q     And assuming that is true, then there would be no  
10 expenses avoided for these two items from the retail rate of  
11 the R-1 service?

12          A     You are saying that assuming that those rates  
13 recovered costs, then there would be no avoided costs, is  
14 that what you are asking?

15          Q     I want you to assume that none of those costs are  
16 recovered through the R-1 rate.

17          A     Okay.

18          Q     And if they are not recovered under the R-1 rate,  
19 under the definition of what costs should be avoided those  
20 expense would not be avoided, would they?

21          A     Based on that hypothetical, yes.

22          Q     Thank you. Does AT&T have a national retail  
23 organization?

24          A     I don't know.

25          Q     You don't know?

1           A     No.

2           Q     Now, Mr. Lerma, even though you took out the  
3 access expenses in your second study, the total discount  
4 rate has actually increased from the first study to the  
5 second study?

6           A     That's correct.

7           Q     What are the differences between the first study  
8 and the second study?

9           A     Well, there is a very major difference that you  
10 are looking at a discount that considers all costs and is  
11 applicable to all rates. The first discount specifically  
12 looked at only the cost of local. So the second study takes  
13 into consideration the costs of toll, private line, combines  
14 all of those, and comes up with a uniform discount that is  
15 applicable to all the retail services. The first one was  
16 just for local.

17          Q     And why did you make, why did you decide to do a  
18 second study?

19          A     Well, the second study pretty much in addition to  
20 complying with the act, with the provisions of the act, also  
21 is consistent with the FCC order and rules and requires no  
22 allocations. It very specifically goes through and uses the  
23 formula provided by the FCC in the order and rules. The  
24 original study went through an allocations process that was  
25 required to come up with specific services, and that was one

1 of the things that the FCC commented in its order that they  
2 had not had an opportunity to review the allocations and  
3 were looking for a more simplistic approach. And AT&T's  
4 intention was with the second study to do exactly that. It  
5 would require no analysis of allocations, it's a  
6 straightforward approach.

7 Q Did you change any of the formulas from the first  
8 study to the second study?

9 A There is no relationship whatsoever, because  
10 you're looking at the first study was a service-specific  
11 study that included allocations. There are no -- there is  
12 basically no formulas. You start with the ARMIS report, the  
13 amounts booked in each ARMIS account, and then follow the  
14 specific presumptions in the FCC order and rules.

15 Q Going to Page 19 of your testimony, your direct  
16 testimony?

17 A Yes.

18 Q The question beginning on Line 8, does a wholesale  
19 rate that excludes all retail costs result in a below cost  
20 rate?

21 A Yes.

22 Q And your answer is no. And let's go to the second  
23 reason for that answer, that the rate plus subsidies  
24 received from other local service rates, customer calling  
25 services, or other classes of service, subscriber line

1 charges, cover all of GTE's wholesale costs. Do you see  
2 that?

3 A Yes.

4 Q I mean, aren't you describing here the implicit  
5 subsidy that has been, you know, sanctioned by this  
6 Commission where GTE would offer below cost services to be  
7 made up from other services, such as toll and vertical  
8 services?

9 A Yes, in part. Basically, what I'm saying here is  
10 that whatever exists today with respect to any subsidies to  
11 the extent that they were necessary, is based solely on what  
12 is happening here, is not changing, and then specifically it  
13 is consistent with what the FCC concluded in its order and  
14 rules. Paragraph 956 of the FCC order and rules  
15 specifically mentions that basically what is happening here  
16 nothing changes. There is avoided costs, retail rates are  
17 changed by the amount of avoided costs. To the extent that  
18 there was subsidies that were flowing before, that's not  
19 impacted.

20 Q I will accept if the customer goes with AT&T those  
21 subsidies provided by toll and custom calling features will  
22 go to AT&T rather than to subsidize GTE's below cost  
23 services. Isn't that a change?

24 A In a competitive environment there is lots of  
25 things that can happen, but specifically what we -- the

1 charge we have here is to identify avoided costs, and that  
2 is not included in that charge.

3 Q But isn't that what is going to happen when AT&T  
4 takes a customer away from GTE, those subsidies sanctioned  
5 by this Commission will go away, will they not?

6 A I can't agree with that. I don't know that. And  
7 specifically just a year ago, when this Commission issued  
8 its order in the universal service proceeding, at that time  
9 GTE and BellSouth both put forward arguments that that was  
10 exactly what was going to happen, that competition was going  
11 to take some of those contributions away. And this  
12 Commission decided that that couldn't be proven at this time  
13 and decided to move on and deal with that later.

14 Q Okay. Well, I have two Page 2 of 2s.

15 A I think that is a continuation. It should have  
16 been printed on one page, but that's all one page.

17 MR. GILLMAN: Chairman Clark, I don't believe I  
18 have any more questions of this witness, but I would like to  
19 have some time to review these studies. And I will commit  
20 to you that if I have any additional questions, that I will  
21 only ask them on these studies that have been added. And I  
22 would propose to recall Mr. Lerma tomorrow to ask him  
23 questions, possibly none, on these studies that were just  
24 handed to me.

25 MS. DUNSON: That's fine with us, Chairman Clark.



1 We realize it was our filing error, and that's fine.

2 MR. GILLMAN: I have no further questions at this  
3 time, subject to recall.

4 CHAIRMAN CLARK: Thank you, Mr. Gillman. Staff,  
5 how much do you have?

6 MS. CANZANO: Three questions.

7 CROSS EXAMINATION

8 BY MS. CANZANO:

9 Q Good evening, Mr. Lerma.

10 A Good evening.

11 Q I just want to clarify some of the questions and  
12 responses that you gave to Mr. Gillman. If I am an AT&T  
13 local customer of resold services, do I pay the subscriber  
14 line charge?

15 A It's my understanding that that will appear on the  
16 bill, yes.

17 Q And who would I pay that to?

18 A You would pay that to AT&T.

19 Q Is it appropriate to consider the subscriber line  
20 charge, which is used to recover interstate non-traffic  
21 sensitive costs, as supporting local rates?

22 A I'm sorry, repeat that question again.

23 Q Is it appropriate to consider the subscriber line  
24 charge, which is used to recover interstate non-traffic  
25 sensitive costs, as supporting local rates?

1           A       If the question is should they be included as a  
2 revenue subject to discount, I would say no. In other  
3 words, it's not a revenue or a service that's going to be  
4 discounted, so it shouldn't be part of the formula to work  
5 up your avoided cost discount.

6           CHAIRMAN CLARK: Mr. Lerma, are you saying then  
7 that that charge should remain, should be part of the  
8 wholesale charge made to you?

9           WITNESS LERMA: It's my understanding we will  
10 recover that from the customer, but that eventually it does  
11 go to GTE. That's a cost that GTE is entitled to to recover  
12 cost of its network. But the recovery is what I'm talking  
13 about, you know, that it's my understanding it will be  
14 recovered on AT&T bills and then there is a transfer of that  
15 between the companies. But, I don't understand that there  
16 will be any kind of discount that would be applied to that  
17 rate.

18           CHAIRMAN CLARK: Well, do you think it would be  
19 appropriate to apply a discount?

20           WITNESS LERMA: No, I do not.

21           CHAIRMAN CLARK: Okay.

22 BY MS. CANZANO:

23           Q       In your opinion, are the USOA accounts provided in  
24 the FCC's order regarding avoided cost consistent with the  
25 term avoided cost pursuant to the act?

1           A     Yes, I do.

2           Q     And what is the basis for your response?

3           A     The basis for my response is in my direct  
4 testimony. I specify the specific categories of cost that  
5 in the act are concluded as being avoided. And generally  
6 they were marketing, billing, collection, and other costs.  
7 And I specify that the categories in the marketing category  
8 were 6611, 12, and 13, which were some of the ones that I  
9 mentioned here. The billing and collection costs appear in  
10 Account 6623, which is another one of the accounts that is  
11 presumed avoided in the FCC order and rules. And so  
12 specifically those are the main categories that apply in the  
13 FCC order and rules, in addition to the operator services  
14 category that would fall under the other category.

15          Q     And my question is, in your opinion, these are  
16 consistent with the act?

17          A     Yes, they are.

18               MS. CANZANO: Thank you. Staff has no further  
19 questions.

20               CHAIRMAN CLARK: Commissioners. Redirect.

21               MS. DUNSON: No redirect.

22               CHAIRMAN CLARK: Exhibits.

23               MS. DUNSON: AT&T moves Exhibits 13 and 14.

24               CHAIRMAN CLARK: Why don't we wait on 14 until  
25 tomorrow.

1 MS. DUNSON: Okay. That's fine.

2 CHAIRMAN CLARK: We will allow -- 13 will be  
3 entered in the record without objection, and Mr. Lerma will  
4 be available tomorrow should Mr. Gillman have any more  
5 questions. Thank you, Mr. Lerma.

6 (Exhibit 13 received into evidence.)

7 WITNESS LERMA: Thank you.

8 CHAIRMAN CLARK: Well, I'm inclined to adjourn the  
9 hearing now, but I am still concerned about getting the  
10 hearing concluded in the time allotted. So if we don't make  
11 better progress we will be here later tomorrow. Thank you  
12 very much. Commissioners, is 9:00 o'clock acceptable  
13 tomorrow? We will start the hearing at 9:00 o'clock  
14 tomorrow. Thank you very much.

15 (Transcript continues in sequence in Volume 6.)

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