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February 20, 1996

BY HAND DELIVERY

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

Re: Docket No. 950985-TP (Sprint-GTEFL)
(Local Interconnection)

Dear Ms. Bayó:

Enclosed for filing on behalf of MCI Metro Access Transmission Services, Inc. (MCImetro) in the above referenced docket are the original and 15 copies of the rebuttal testimony of Dr. Nina Cornell.

By copy of this letter this document has been provided to the parties on the attached service list.

Very truly yours,

RDM

Richard D. Melson

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cc: Parties of Record

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY OF

DR. NINA W. CORNELL

ON BEHALF OF

MCI METRO ACCESS TRANSMISSION SERVICES, INC.

DOCKET NO. 950985-TP

MFS INTERCONNECTION PETITIONS RE SPRINT AND GTEFL

FEBRUARY 20, 1996

Q. WHAT IS YOUR NAME AND ADDRESS?

A. My name is Nina W. Cornell. My address is 1290 Wood River Road, Meeteetse, Wyoming 82433.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony responds to the testimonies of Dr. Beauvais on behalf of GTE Florida Incorporated (GTEFL) and Mr. Poag on behalf of Sprint-United/Centel.

Q. WHAT DOES DR. BEAUVAIS RECOMMEND THE COMMISSION DO ABOUT INTERCONNECTION IN THE SHORT RUN?

A. Dr. Beauvais wants the Commission to order the use of switched access charges without the application of the Carrier Common Line Charge or the Residual Interconnection Charge as the rate to use for compensation for terminating local exchange traffic.

Q. DO YOU AGREE WITH THAT RECOMMENDATION?

A. No. The rates Dr. Beauvais wants to use are far above cost, and would create a barrier to entry. This would slow or prevent the development of local exchange competition. The Commission should order Mutual Traffic Exchange, as I discussed in my direct testimony.

Q. WHY WOULD USE OF SWITCHED ACCESS CHARGES, BUT WITHOUT THE CARRIER COMMON LINE CHARGE AND THE RESIDUAL INTERCONNECTION CHARGE, CREATE A BARRIER TO ENTRY?

A. Any rate charged for terminating calls that is higher than the total service long run incremental cost per unit of providing that service would create a barrier to entry.

As I noted in my direct testimony (page 5, lines 13-14), any time an entrant faces costs that are higher than the costs faced by the incumbent for an input, it creates a barrier to entry. The charge that Dr. Beauvais wants to impose for terminating local exchange traffic is a cost that the entrant cannot avoid. If Dr. Beauvais' recommendation were adopted, the cost to an entrant to terminate a call to a customer of GTEFL would be equal to the switched access charge minus the Carrier Common Line Charge and the Residual Interconnection Charge, but the cost to GTEFL to terminate the same call would only be the unit TSLRIC of termination. When the cost of an input that an entrant can get nowhere but from GTEFL is higher to the new entrant than to GTEFL, the result is an artificial barrier to entry.

Q. DR. BEAUVAIS SAYS THAT IT IS INCONSISTENT TO ARGUE THAT HIGH INTERCONNECTION CHARGES ARE A BARRIER TO ENTRY AND AT THE SAME TIME ARGUE THAT TRAFFIC IS LIKELY TO BE IN BALANCE. DO YOU AGREE?

A. No. The claim that traffic will be in balance is a statement about what conditions are likely to be over some period of time. That period is likely to be longer than a normal telephone company billing period of a month. Moreover, the market conditions for traffic balance to be more certain, namely true service provider number portability, have not yet been put into place. Under these conditions, even if traffic is in balance over a year, for example, the inability to predict with certainty for any given month means that the entrant will have to ensure that it has sufficient cash flow each month to meet the bill of the incumbent. Even if traffic is in balance in terms of the number of minutes of use, because the *percentage* of calls originated on the network of the entrant that terminate on the network of the incumbent is likely to be much higher than is the percentage of calls that originate on the network of the incumbent and terminate on the network of the entrant, the need to ensure a sufficient cash flow to be able to pay whatever might be the monthly bill for local termination will fall much more heavily on the entrant than on the incumbent. The only way the entrant can ensure it has sufficient cash flow to meet these bills each month is if the entrant recovers the possible interconnection charge in the rates it charges for local calling.

Q. DR. BEAUVAIS ALSO CLAIMS THAT THE COST OF MEASUREMENT AND BILLING IS VERY LOW, AND THAT ENTRANTS MUST CREATE BILLING SYSTEMS FOR SWITCHED ACCESS IN ANY EVENT. THUS, HE CLAIMS THERE ARE NO REAL SAVINGS IN TRANSACTIONS COSTS IF MUTUAL TRAFFIC EXCHANGE IS THE METHOD OF COMPENSATION. DO YOU AGREE?

A. No. Dr. Beauvais has relied on data for measurement and billing costs that do not apply to the measurement and billing for the method of interconnection he proposes to use. Moreover, in order to make his proposed system work, he proposes to require entrants to use separate trunks to bring local exchange traffic to GTEFL, and he proposes also to audit the traffic that is on those trunks to ensure that the entrants are not cheating. All of these proposals add costs to entrants disproportionately to the costs imposed on GTEFL, creating additional barriers to entry. The costs Dr. Beauvais would add are unnecessary.

The fact that the entrants have to create switched access measurement and billing systems is not relevant to the costs that would be incurred to create measurement and billing systems for local exchange traffic.

Q. WHAT IS THE PROBLEM WITH THE DATA DR. BEAUVAIS HAS USED TO CLAIM THAT THE COSTS OF MEASUREMENT AND BILLING ARE LOW?

A. Dr. Beauvais used cost figures for measured local exchange traffic to claim that the costs of measurement and billing are low. The problem is that a call terminated for an entrant is not the same as a measured local exchange call, contrary to Dr. Beauvais' claim. Measured local exchange service has the originating switch measure and record the information needed to bill measured local exchange calls. For a local termination of a call that originates on another network, the incumbent local exchange carriers will not be the originating switch. Instead, they will be the terminating switch. As a result, the measurement and billing will not use the same measurement equipment or billing systems as measured local exchange service.

Given Dr. Beauvais' proposal to use switched access charges, it is likely that GTEFL will use its switched access billing system. In the cases where I have seen data on those costs, the measurement and billing costs for a switched access call are much higher than for a measured local service call.

Q. WHAT ARE THE ADDITIONAL COSTS THAT DR. BEAUVAIS WOULD IMPOSE ON ENTRANTS IN ORDER TO IMPLEMENT HIS COMPENSATION PROPOSAL?

A. Dr. Beauvais would impose additional costs by requiring entrants to use separate trunks for local and EAS traffic, rather than being able to terminate both local/EAS and toll traffic over the same trunks.

Today, when an incumbent local exchange carrier terminates a call other than a switched access call, its terminating switch cannot determine whether that call is local or toll. The terminating switch can count the minutes that the trunk is in use, but except for switched access that comes on separate trunks either from the incumbent's tandem or from the interexchange carrier directly, it does not record this information for billing purposes. In order to get around the inability to determine whether calls coming from an entrant are toll or local, Dr. Beauvais would require the entrants to use inefficient trunking in order to help implement his already inefficient compensation proposal. Dr. Beauvais would impose on entrants additional costs due to his requirement that they use separate trunks for different kinds of calls. This would reduce the economies of trunking that would be available to entrants, and increase their costs.

Q. WHY IS IT IRRELEVANT THAT THE ENTRANTS WILL HAVE TO CONSTRUCT MEASUREMENT AND BILLING SYSTEMS FOR SWITCHED ACCESS?

A. It is irrelevant that entrants would have to construct measurement and billing systems for switched access charges because that traffic is not the same as local exchange termination. Technically, the specifications of the trunks used for switched access are different, meaning that switched access traffic will go over segregated trunks. These can be measured in the same way that the incumbents do today. Terminating local calls would not use the kind of trunks that carry switched access calls.

Q. DR. BEAUVAIS ALSO DISAGREES THAT USE OF SWITCHED ACCESS CHARGES WOULD CREATE A PRICE SQUEEZE. DID HE CORRECTLY ADDRESS THIS ISSUE?

A. No. A price squeeze exists whenever an equally efficient firm cannot provide an end user service at the same rate as the incumbent due to the price the incumbent charges the competitor for an essential input. To prove that his compensation proposal would not create a price squeeze, Dr. Beauvais would have had to show that each of GTEFL's local exchange services recovered revenue equal to or greater than the sum of the price he proposes GTEFL charge for local terminations plus all of the costs of the remainder of the inputs into that particular GTEFL local exchange service. He has not made such a showing.

Instead, Dr. Beauvais discusses the prices MFS can choose to charge. According to Dr. Beauvais:

> If MFS cares to offer customers measured options, it is at liberty to establish the prices for its services at whatever levels it chooses. Likewise, if MFS wants to offer customers flat-rated local exchange service, it

> is free to do so. The price of such service only needs to be at a level sufficiently high to cover MFS' costs of providing service. (Beauvais Direct, page 32, line 25, to page 33, line 5)

Nowhere in this passage does Dr. Beauvais recognize two central facts: (1) MFS cannot set its rates for local exchange service at "whatever level it chooses" without regard to the rates GTEFL charges for local exchange service; and (2) a major part of MFS' costs for providing local exchange service are directly under the control of GTEFL, and will be determined by what GTEFL is allowed to establish as the price for local call termination.

Q. WHAT IS THE RELATIONSHIP BETWEEN THE PRICES MFS CAN CHARGE FOR LOCAL EXCHANGE SERVICE AND GTEFL'S PRICES FOR LOCAL EXCHANGE SERVICE?

A. Except for any premium for superior quality that it might be able to charge, GTEFL's prices set the price ceiling for what any entrant can charge if it hopes to win customers. No matter what P. T. Barnum may have once said about people, they do not long agree to switch to new and relatively untried local exchange carriers for the privilege of paying more for their local exchange service. In fact, it is likely that entrants will have to charge less than the incumbent for service of equal quality in order to induce customers to switch. Thus, MFS is not free to set its prices at any level. If GTEFL succeeds in persuading the Commission to allow it to set compensation for terminating calls at a level that creates a price squeeze, MFS may not have any level of local exchange price below the price ceiling set by GTEFL that also allows MFS to cover its costs.

Q. YOU SAID THAT GTEFL IS CONTROLLING A COST OF THE ENTRANTS BY THE LEVEL AT WHICH IT IS ALLOWED TO SET COMPENSATION RATES FOR TERMINATING LOCAL CALLS. DR. BEAUVAIS SAYS THAT GTEFL IS NOT REQUIRED TO MAKE ENTRANTS "FINANCIALLY VIABLE." (BEAUVAIS DIRECT, PAGE 33, LINES 20-21) HE ALSO SAYS "THAT THE PRICE FOR COMPENSATION IS, AFTER ALL, JUST ANOTHER PRICE." (BEAUVAIS DIRECT, PAGE 34, LINES 22-23) DO YOU AGREE?

A. Not entirely. I agree that GTEFL is not required to make entrants financially viable, but it is not permissible that it be allowed to erect artificial barriers to entry either. What Dr. Beauvais has done is to ignore that interconnection is one of a small number of essential monopoly input functions that entrants can only get from the incumbent local exchange company. This makes local exchange markets not like normal markets. Dr. Beauvais is actually asking the Commission to allow GTEFL to take advantage of this almost unique circumstance -- the control over essential monopoly input functions -- to create an artificial barrier to entry that it could not in a normal market, namely the barrier to entry created by making entrants incur higher costs for traffic termination than GTEFL experiences.

Q. WHAT DO YOU MEAN BY A "NORMAL MARKET?"

A. Normal markets generally are markets with essentially no barriers to entry, and in which no firm controls essential monopoly input functions. Such markets would tend over time to be effectively competitive. In such markets, with no one firm being able to control the destiny of another firm directly, each firm has to compete independently and this causes prices to fall as close as possible to cost.

Q. DR. BEAUVAIS ALSO PROPOSES THAT, IN THE LONGER RUN, THE COMMISSION MOVE TOWARDS HIS PROPOSED ORIGINATING RESPONSIBILITY PLAN, WHICH HE CLAIMS WOULD BE MORE EFFICIENT. DO YOU AGREE?

A. No. Dr. Beauvais' proposal is a plan designed to insure it a monopoly, not to create an efficient local exchange market. First, he erroneously claims that a number of kinds of calls are the same, when they are not. This would lead to prices for local call termination that included a higher markup over cost than would be contained in the prices for end to end local calls.

He also wants to price all usage on a declining block basis, a proposal that has two very powerful anticompetitive effects. The first is that such a tariff guarantees that no matter what the rate, the tariff will not be able to pass the proper imputation test. As a result, entrants will always face a price squeeze. The second very powerful anticompetitive effect is that a declining block pricing structure that aggregates the usage over more than one line forces consumers to pay a huge financial penalty if they want to split their usage between two or more carriers. This raises the difficulty an entrant has in getting customers to try its service. The entering interexchange carriers began by taking some, but not all, of the interexchange traffic of large users. Local exchange entrants would be denied this ability under Dr. Beauvais' proposal. The Commission should reject in its entirety Dr. Beauvais' request that it endorse now the ultimate adoption of Dr. Beauvais' longer run proposal.

Q. MR. POAG CLAIMS THAT INCREMENTAL COSTING METHODS ARE NOT USED FOR SETTING PRICES, BUT ONLY FOR TESTING FOR CROSS SUBSIDIES. DO YOU AGREE?

A. No. Indeed, in every docket in which I have been involved around the country since 1981, local exchange carriers have been asking to set their rates, particularly their rates for services subject to competition, on the basis of incremental costs.

Q. MR. POAG CLAIMS THAT IT IS "INAPPROPRIATE" FOR THE INTERCONNECTION RATE OF A LOWER COST COMPANY TO BE SET EQUAL TO THE INTERCONNECTION RATE OF A HIGHER COST COMPANY. DO YOU AGREE WITH MR. POAG'S ANALYSIS?

A. No. Mr. Poag is addressing a belief that in the real world costs between two interconnectors will not be the same. According to Mr. Poag:

> When this occurs and prices are set at the higher incremental cost of the two interconnectors, the competitor having the higher cost will have no recovery of its shared and overhead costs while the competing interconnector will recover more than its

> incremental cost and thus receive a contribution toward its shared and common costs. For the higher cost company, its shared and common costs, if recovered, will have to be recovered, in part, through charges to its end users. The problem is compounded when the higher-cost company is also terminating more traffic from the ALEC than it terminates to the ALEC. (Poag Direct, page 9, line 21, to page 10, line 7)

There are at least three problems with Mr. Poag's argument. Moreover, it is ironic that the outcome that Mr. Poag appears to want, namely different costs to the two companies for terminating calls if their costs differ, would occur under the one termination arrangement he rejects, namely Mutual Traffic Exchange.

Q. WHAT IS THE FIRST PROBLEM WITH MR. POAG'S ARGUMENT?

A. Mr. Poag demonstrates a lack of understanding of how markets work. In normal markets, the market price is set at the cost of supplying the last unit demanded. If one firm is more efficient than another firm in that market, it receives higher markups over its costs at that market price than the higher cost firm receives. There is no mechanism in a competitive market to ensure that the higher cost firm can continue to be higher cost and still recover all of its costs. One of the major benefits to consumers from competitive markets is that when the situation described by Mr.

Poag arises, the higher cost firm is forced to become more efficient -- to become a lower cost firm. Mr. Poag wants to prevent consumers from getting this benefit.

Q. WHAT IS THE SECOND PROBLEM WITH MR. POAG'S ARGUMENT?

A. The second problem with Mr. Poag's argument is that he assumes that it is proper for the incumbent local exchange company to charge a rate for interconnection that helps to recover some of its shared and common costs. In fact, the most efficient way to structure the market is to require all interconnectors to recover their shared and common costs from end users, not from each other. The reason for this is precisely to force higher cost firms to become lower cost firms. Any markup in the interconnection charge cannot be competed away, so it is protected, whereas markups in end user rates are subject to market pressures for greater efficiency.

Q. WHAT IS THE THIRD PROBLEM WITH MR. POAG'S ARGUMENT?

A. Mr. Poag is simply wrong that it makes things worse if the higher cost company terminates more calls than the lower cost company. The amount of shared and common costs that a company has to recover is unaffected by the volume of calls that it terminates for the other company.

Q. MR. POAG CLAIMS THAT IT IS TOTALLY "ILLOGICAL" TO CLAIM THAT CHARGING FOR INTERCONNECTION AT A RATE THAT IS HIGHER THAN COST SHIELDS THE COSTS RECOVERED FROM THE MARKUP FROM MARKET PRESSURES. IS HE CORRECT?

A. No. Mr. Poag genuinely does not understand what market pressure means. The price for interconnection cannot be pushed down by market forces because there is no alternative for terminating traffic to subscribers who remain with the incumbent other than use of the incumbent's local termination. What this means is that, even if in fact the incumbent became more efficient, no market force exists to force the incumbent to reflect that greater efficiency in a lower interconnection charge. Therefore that efficiency also would not be reflected in the end user prices charged by the entrant, which in turn protects the end user prices that the incumbent will charge in the future. The fact that the incumbent might become more efficient in a cost-cutting sense is of virtually no benefit to consumers unless they get the benefits in lower prices.

Q. MR. POAG ALSO CLAIMS THAT A PRICE SQUEEZE IS MEASURED ONLY BY LOOKING AT TOTAL COSTS TO THE NEW ENTRANT RELATIVE TO TOTAL REVENUES, TAKING ALL SERVICES INTO ACCOUNT. IS HE CORRECT?

A. No. He has misunderstood what a price squeeze is and why it matters. The question is not whether some particular entrant, having surmounted all the natural barriers to entry and the artificial barriers created by Mr. Poag's interconnection pricing proposal, actually is profitable. A price squeeze is bad for the public because it prevents a firm that is just as efficient as the incumbent from entering and surviving in the market. A price squeeze exists if the incumbent's rate for an end user service for which the incumbent supplies an essential monopoly input function is set higher than the sum of the rate charged for that essential monopoly input function plus the cost of all of the other inputs used by the incumbent to provide the end user service.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.