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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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In re: Resolution of petition(s) to establish nondiscriminatory rates, terms and conditions for resale involving local exchange companies and alternative local exchange companies pursuant to Section 364.161, Florida Statutes	)	Docket No. 950984-TP Filed: April 5, 1996

POST-HEARING STATEMENT AND BRIEF OF GTE FLORIDA INCORPORATED

GTE Florida Incorporated (GTEFL) files this Post-Hearing Statement and Brief in accordance with Commission Order No. PSC-96-0137-PCO-TP, issued January 31, 1996 in this docket.

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Introduction and Statement of Basic Position

GTEFL understands that providing certain network services on an unbundled basis will be important to fostering competition in the local exchange market. To this end, GTEFL has agreed to make available unbundled loops and any required transport, unbundled ports, and channel multiplexing to MFS of Florida, Inc. (MFS). Although GTEFL has reached an agreement with MFS regarding the level of unbundling and other technical issues, negotiations regarding the price of the unbundled elements failed because of MFS' insistence that the elements be priced at their long run incremental cost (LRIC). Pricing the unbundled elements at LRIC is economically unsound, confiscatory and advantageous only to MFS and other alternative local exchange carriers (ALECs).

The pricing of unbundled elements must be based on proper economic principles if fair and efficient competition is to develop. The Commission has neither the obligation nor the right to subsidize or favor the entry of individual competitors over incumbent LECs. Rather, in establishing prices, the Commission should emulate competition as closely as possible and allow the marketplace to decide which companies will be successful. In a competitive market, the appropriate price for wholesale services would fall between average stand-alone costs (as a ceiling) and total service long-run incremental costs (TSLRIC) (as a floor). Prices should not be set equal to LRIC or TSLRIC, as advocated by MFS and the other ALECs because such an approach will deny GTEFL the ability to recover its costs of common and/or shared facilities and equipment, costs which would be recovered in a competitive market. The end result of such action sends the wrong price signal to the market, and more significantly, absent rate rebalancing, will prevent multi-product firms such as GTEFL and other incumbent LECs from earning a reasonable return. Indeed, LRIC only approximates 40% of GTEFL's retail cost. Thus, a contribution of 150% is required to bring the company back to its existing revenue requirement.

GTEFL has proposed a rate of $23.00 for basic unbundled loops, which is identical to the company's currently tariffed 2-wire special access line rate. Even at this rate, GTEFL will experience a significant loss of contribution. Ideally, GTEFL would have proposed this rate in conjunction with comprehensive rate rebalancing. However, because rate rebalancing is restricted under Florida law as currently enacted, the Commission must immediately consider universal service funding and other mechanisms to address the economic and legal concerns GTEFL has set out. Absent such action, to avoid confiscation of its property, GTEFL must consider such judicial remedies as it believes appropriate. Quite simply, GTEFL expended funds in the status of a sole provider under

Chapter 364 until the recent revision to Section 364.335, which opened up the local market. The revenue streams established by the Commission prior to January 1, 1996 for GTEFL will not exist in a competitive environment and the Commission must address any shortfalls created by unbundling to avoid confiscation of GTEFL's investment.

Statement of Position on Specific Issues

Issue 1: *What elements should be made available by GTEFL to MFS on an unbundled basis (e.g., link elements, port elements, loop concentration, loop transport)?*

GTEFL Position: This issue has been fully stipulated between GTEFL and MFS and cannot now be decided by the Commission. Rather, this issue is controlled by the terms and conditions set forth in the GTEFL/MFS agreement which was approved by the Commission before evidence was taken in this docket (T. 13, Ex. 4).

Issue 2: *What are the appropriate technical arrangements for the provision of such unbundled elements?*

GTEFL Position: This issue has been fully stipulated between GTEFL and MFS and cannot now be decided by the Commission. Rather, this issue is controlled by the terms and conditions set forth in the GTEFL/MFS agreement which was approved by the Commission before evidence was taken in this docket (T. 13, Ex. 4).

Issue 3: What are the appropriate financial arrangements for each such unbundled element?

GTEFL Summary of Position: ** Under the efficient component pricing rule, prices should fall between stand-alone and TSLRIC costs. Pricing at TSLRIC is confiscatory as it denies the firm's *ability* to obtain any contribution to its common and/or shared costs. This result is unfair and inimical to efficient competition. **

GTEFL Position: Sound economic principles compel pricing for unbundled elements to be set as they would be in a competitive marketplace. As such, prices for these wholesale services should fall between stand-alone costs and total service long-run incremental costs. Prices should not be set at LRIC as recommended by MFS or, for that matter, TSLRIC levels as recommended by the other ALECs. Either approach will drive firms out of business, as they will be unable to obtain any contribution to their joint and common and/or shared costs--not to mention general and administrative overhead expenses. All of the foregoing categories of costs must be recovered before a firm can produce positive net operating income. Denying GTEFL recovery of these costs is unfair and inimical to efficient competition. Moreover, it is inconsistent with the Telecommunications Act of 1996 which authorizes incumbent LECs to recover a "reasonable profit" after the LECs' costs are recovered. *Telecommunications Act of 1996*, Pub. L. No. 104-104, §252(c)(1). To comply with the Act, GTEFL contends that the Commission must permit GTEFL to recover all costs plus a reasonable profit. The provisions of the Act expressly control the decisions of the Commission in this instance. LRIC and TSLRIC fail to meet the requirements of the Act because by definition, they do not cover all costs nor provide a profit to the firm. GTEFL proposes to charge $23.00 for a basic unbundled loop. This rate is the same as GTEFL's currently tariffed rate for a 2-wire special access line. Despite arguments raised by MFS otherwise, this rate will not possibly cause a price squeeze to the disadvantage of MFS or any other ALEC. On the contrary, even if GTEFL's proposed rate is approved, GTEFL will be placed at a disadvantage because of the social pricing practices mandated by the Commission in the past. Adoption of the $23.00 rate will not prevent GTEFL from losing a tremendous amount of contribution with only a small percentage loss of local market share (Trimble Direct, pp. 12-13). However, given current state legislation, GTEFL does not propose to correct all pricing problems that beset GTEFL and other incumbent LECs in this proceeding (T. 456). Rather, the Commission must immediately address this expected loss of contribution in a comprehensive universal service docket or in some other proceeding to avoid confiscation of the company's property.

Even though GTEFL will lose significant contribution if the $23.00 is approved, it would be meaningless in the market to charge any other higher rate because an unbundled loop and a private line are essentially the same. Accordingly, the existing $23.00 rate has established a price ceiling on the unbundled loop. However, GTEFL is still entitled to rates which return to the company all funds expended in the deployment of assets under the *de jure* local monopoly which was in effect until January 1, 1996. To accomplish this, the Commission must immediately order a rate rebalancing or explicit subsidy payments at the same time the unbundled rates go into effect. If the Commission refuses to deal with the confiscation of the company assets in this case, GTEFL will be forced to pursue appropriate remedies to rectify the situation.

A. Existing Special Access Rate Is An Appropriate Rate To Price An Unbundled Loop.

Although GTEFL's proposed rate of $23.00 does not resolve the underlying problems with its current cost and rate structure, it is clearly an appropriate rate for unbundled loops. As explained in more detail below, GTEFL's proposed rate complies with the efficient component pricing rule, lessens the potential for arbitrage, covers its total service long-run incremental service costs for this service, encourages entry of more efficient, lower cost competitors, and provides a modest contribution to joint and common costs. It clearly constitutes a just, reasonable and non-discriminatory rate which the Commission should approve in conjunction with an order creating a mechanism to avoid confiscation of the company's property.

1. GTEFL's Proposed Rate Meets the Efficient Component Pricing Rule, a Rule Which Encourages Fair and Efficient Competition, Not the Creation of Biases for Individual Competitors.

In establishing rates for unbundled services, the Commission's goal should not be to ensure that MFS or any other ALEC is successful in a competitive market on an artificial basis, as appears to be the objective of MFS and the other ALEC witnesses. The Commission's obligation is to encourage efficient *competition*, not to benefit or hamstring individual *competitors*. The legislature specifically found that the "competitive provision of telecommunication service, including local exchange telecommunication service is in the public interest" and that competition will "encourage the introduction of new telecommunications service, encourage technological innovation and encourage investment in telecommunications infrastructure." Fla. Stat. §364.01(3). By contrast, the legislature did not create a policy goal of ensuring the success of inefficient competitors. Nor did it find that competitors should be afforded competitive advantages over incumbent LECs.[1] As such, in establishing rates for unbundled loops, the Commission should set a price *in a manner* compatible with a competitive marketplace, not in a manner which would ensure the success of MFS, regardless of MFS' relative efficiency or competitive strength.[2]

The efficient component pricing rule (ECPR), a rule developed and propounded by numerous academic luminaries,[3] provides the mechanism for the Commission to meet the legislative goals of encouraging efficient competition and establishing prices which would be produced in a competitive market (Duncan Direct, p. 3). This concept in pricing, as explained by GTEFL's economist, Dr. Gregory Duncan, encourages entry by efficient entrants while discouraging entry by those who are not (T. 464). Because the rule

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[1] The legislature has afforded ALECs an advantage over incumbent LECs only in the form of less restricted regulation. Fla. Stat. §364.01(4)(d). Furthermore, this inequality regarding regulatory oversight applies only for a "transitional period." *Id.*

[2] Indeed, during cross-examination, MFS witness Tim Devine seemed to suggest that MFS was entitled to special treatment because of Mr. Devine's perception that MFS was at a competitive disadvantage compared to larger companies such as AT&T (T. 138). He testified that "one of the big things we (MFS) are up against is we're MFS; and when you ask a customer, they say, 'Well who's MFS.' We don't have the AT&T logo, the MCI logo, the Spring logo, even the GTE logo" (T. 138).

[3] As noted by Dr. Duncan, the efficient component pricing rule is not a theory developed by GTE for this hearing or any other proceeding. Rather it was developed long ago by William Baumol, an economics professor at Princeton and has since been propounded by many other noted economists, including Princeton University Professor, Robert Willig, Paul McAvoy, the former dean of Yale University Business School and Alfred Kahn, the "great guru of regulation" (T. 454, 465).

promotes only efficient entry, it emulates a competitive market which will lead to lower prices and thereby benefit consumers (T. 455).

Under the ECPR, the price of an unbundled loop is determined by computing the TSLRIC of that element, adding the costs of wholesale activities, subtracting avoided retail costs and adding the contribution to margin lost by the firm in selling the service rather than using it itself (T. 455). In no event shall the price exceed the stand alone cost of providing the element (Duncan Direct, p. 5). Applying the ECPR to the facts at hand, GTEFL witness, Dennis Trimble, calculated the TSLRIC for unbundled loops, the wholesale costs of providing unbundled loops and the lost opportunity costs to develop a price for a 2-wire unbundled loop (Ex. 12, Table 3).

Mr. Trimble's analysis depicts the impact the Commission's social pricing policies has upon GTEFL after enduring years of rate of return regulation. As set forth in Table 3 of Exhibit 12, significant contribution to joint and common costs is generated by business customers. Through past rate case orders, the amount of contribution for business service was intentionally kept artificially high in order to ensure that local residential rates remained low even in high cost areas (Trimble Direct, pp. 8-9). If GTEFL sought to impose a price sufficient to recover its current and necessary contribution levels, GTEFL would need to propose a rate of $61.29 (Trimble Direct, p. 8).

However, the ECPR recognizes market realities and does not support the "contribution-preserving business rate" of $61.29. As such, GTEFL is not proposing that rate in this docket. That rate unquestionably exceeds the stand alone costs of an entrant to provide the loop itself (Trimble Direct, p. 8). The price must neither be set too low nor too high. For if set too high, the rate will incent inefficient entry of facility-based providers (Trimble Direct, p. 8). Because $61.29 exceeds the reasonable estimates of the stand alone costs, GTEFL proposes only to charge $23.00 which is equal to the current rate for a 2-wire special access line contained in GTEFL's Intrastate Access Tariff (Trimble Direct, p. 9). The fact that GTEFL is proposing to charge only $23.00 dispels all ALEC suggestions that GTEFL is seeking to be made whole in this proceeding. The exact opposite is true; GTEFL stands to lose millions of dollars with a mere ten percent market share loss (Ex. 12, Table 4).

2. Use of the $23.00 Special Access Rate Avoids the Potential for Arbitrage.

In addition to being consistent with the efficient component pricing rule, GTEFL's proposed $23.00 rate will also avoid arbitrage opportunities. The special access loop is a direct substitute for the unbundled loop being proposed by GTEFL in this case. As noted by GTEFL witness Dennis Trimble:

> The overwhelming rationale for this rate is that it already exists for what is (for all practical purposes) an identical type service. The pricing of an unbundled loop (i.e. a 2-wire dedicated facility) at rates other than the current special access tariff rates would only result in the lowest rate becoming the rate for all identical services. If the Company were to propose a tariffed rate for unbundled loops that is higher than its current special access rate, an ALEC would just order from GTEFL's special access tariff. If the Company were to propose an unbundled basic loop that was lower than its current special access rate, then end user customers will migrate to the lower special access rates (whether by their own initiative or by an ALEC's initiative) which would only serve to put more of the Company's contributions at risk.

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(Trimble Direct, p. 10). Arbitrage problems have been common between business and residential classes of service and the interstate and intrastate jurisdictions for years (Trimble Direct, p. 9). There is no reason to create yet another arbitrage problem with respect to the sale of unbundled loops. Setting the rate higher or lower than the currently tariffed special access rate will create arbitrage opportunities which will be virtually impossible to prevent.

3. GTEFL's Proposed Rate Appropriately Provides a Contribution to Joint and Common Costs.

The special access price proposed by GTEFL provides only modest amounts of contribution to joint and common costs. As shown by Exhibit 14, the amount of contribution is only 17 per cent, a level of contribution which does not even approach the two-to-three times contribution testified to by Mr. Devine (T. 121-22). As recognized by commissions from other jurisdictions, it is entirely appropriate and necessary to include a contribution to joint and common costs in the unbundled loop rate. *See e.g.*, *Application of the Southern New England Telephone Co. For Approval to Offer Unbundled Loops, Ports, and Associated Interconnection Arrangements*, Docket No. 95-06-17 (DPUC December 20, 1995). In that case, the Connecticut Department of Public Utility Control recognized that interconnection prices must be set above TSLRIC because prices set at TSLRIC will provide inadequate cost recovery. The Commission found:

> TSLRIC, however, does not capture some costs incurred by the provider in the conduct of making available a particular service, which costs are otherwise reflected in FDC methodologies and for which the provider is

> entitled to be compensated. These costs are generally referred to as common or shared costs and are not sufficiently distinguishable to be incorporated into a TSLRIC study. In FDC studies, such costs would be included at the aggregate cost level and apportioned over each unit of service. Thus, recovery of those costs would be the shared responsibility of users of the associated service.
>
> The Department has previously concluded that telephone companies are rightfully entitled to recover prudent common costs in the course of designing prices for their services. *Given the fact that TSLRIC methodologies make no provision for the incorporation of such costs into their analysis framework, the cost thresholds generated by TSLRIC do not represent a fair and reasonable price for the service.* The Department has recognized that fact and has thus endorsed the principle of contribution as a means to satisfy some of those common or shared costs incurred in the provision of the respective service. [citation omitted.] Contribution represents nothing more than a monetary increment above the TSLRIC cost reflected in the margin for any given service. The amount of contribution approved through any given tariff should theoretically be sufficient to reduce the pool of unrecovered costs associated with the service over some period of time. Contribution, therefore, provides a pool of funds that will offset in part, if not in total, common costs not included in TSLRIC.

Id. at 12-13 (emphasis added). Similarly, the Maryland Public Service Commission expressly allowed interconnection prices above TSLRIC, stating that Bell Atlantic was "entitled to recovery of a share of its joint and common costs in the price for interconnection." *In the Matter of the Application of MFS Intelenet of Maryland, Inc. For Authority to Provide and Resell Local Exchange and Interexchange Telephone Service*, Case No. 8584, Phase II, Order No. 72348, (MPSC December 28, 1995). In reaching this conclusion, the Maryland Commission recognized that "all carriers will need to recover joint and common costs if they are to remain in business." *Id.* See also, *Re Illinois Telephone Company,* Docket Nos. 94-0096, 94-0177, 94-0146, *Order* at 74 (April 7, 1995) (rate allows a reasonable level of contribution to Illinois Bell's overhead costs). These regulatory decisions (and many others) recognize the need for a LEC to recover reasonable joint and common costs from its wholesale services, as well as from its retail services. It would be patently unfair for ALECs and their customers to avoid any contribution towards the extensive shared costs and common costs incurred by GTEFL in operating its network.

MFS' contention that prices should be set at LRIC should be summarily rejected (Devine Reb., pp. 5-6). Not even the other ALECs agree with MFS' LRIC proposal. MCI Metro's witness Nina Cornell at least advocates that TSLRIC should be used in pricing unbundled loops (Cornell Direct, p. 7). Unlike MFS, Dr. Cornell acknowledges that both incremental volume sensitive and insensitive costs should be included in setting rates (T. 279). The only other IXC/ALEC providing testimony, AT&T, also advocated use of TSLRIC to price the local loops (Guedel Direct, p. 13).

However, prices should not be set at TSLRIC either. The TSLRIC represents the price *floor*, not the price itself (Duncan Direct, p. 4). The TSLRIC price is neither the optimum price nor a price which would be driven in a competitive market; instead, it is the *lowest* average price a firm would accept before shutting down (Duncan Direct, p. 4). As explained by GTEFL witness Dr. Gregory Duncan, a firm which prices its services at TSLRIC "could not cover the costs of common and/or shared facilities and equipment, and it would eventually go bankrupt" (Duncan Direct, p. 4).

In essence, MFS and the other ALECs are insisting that GTEFL lose money. As noted above, it is clear that residential rates are not covering their TSLRIC and are thus being subsidized by other services (Duncan Direct, p. 11). If GTEFL is required to wholesale a product previously used to help defray the cost of residential service, then GTEFL loses a source for this cross-subsidy and places additional burdens on other services. Indeed, the burden on other services will be even greater because those services must now cover not only the unrecovered part of TSLRIC and residential common costs, but also the common cost of the wholesale product (Duncan Direct, p. 11). Furthermore, as competition drives every service set with artificially high levels to their competitive levels, GTEFL will be left with no sources of contribution for residential service and will be forced operate at a loss by failing to recover these costs. Setting rates at TSLRIC also sends the wrong price signals to the market and, to make matters even worse, GTEFL is currently restricted from raising its residential rates to cover their costs. As previously noted, this situation needs to be rectified to avoid confiscation of the GTEFL's property.

In a competitive market, no firm would sell to MFS at rates capped at LRIC or TSLRIC under such circumstances. As Dr. Duncan aptly explained:

> To use an analogy, Mr. Devine seems to be claiming that requiring a grocery store to sell its entire inventory to him at direct cost, without costs for storage, for the store floor space, for the employees who clean the store and then requiring the store to provide space for him to resell that inventory at some allocated cost per foot, is a fair and equitable way for a grocer to make money doing business with Mr. Devine. Clearly this is not fair or equitable, and no grocer would agree to it.

(Duncan Direct, p. 12). Like the grocer in Dr. Duncan's analogy, GTEFL also has significant joint and common costs which are incurred as a part and parcel in the provision of an unbundled loop. MFS claims that the GTEFL has an advantage because its ubiquitous network is already in place (Devine Direct, pp. 12-13). However, MFS refuses to acknowledge that this ubiquitous network continues to involve significant capital investment and maintenance costs by the LEC. Yet, if prices are set at LRIC or TSLRIC, MFS and other ALECs will get the benefit of this costly network at fire sale rates. Moreover, although MFS witness Tim Devine refused to admit it, it is not likely that any other MFS vendors will sell or lease their products at LRIC or TSLRIC levels (T. 141-42). These other vendors clearly recover their joint and common costs in their rates. GTEFL should not be treated differently.

In his rebuttal testimony, Mr. Devine testified that the Commission should simply ignore the economic consequences to GTEFL if it is forced to provided unbundled loops at its LRIC or TSLRIC level (Devine Reb. pp. 6-7). MFS contends that these consequences will not materialize because the number of unbundled loops provided by GTEFL will be "*de minimis*" in number (Devine Reb. p. 6). Mr. Devine is incorrect for at least two reasons. First, his factual premise is wrong. There is no reason to believe that the number of loops lost by GTEFL to competition will be *de minimis*. On the contrary, AT&T witness Mike Guedel acknowledged that AT&T has publicly announced plans to capture 30% of the local market within the next five to ten years by itself (T. 323). This does not even consider the market share gains which will be made by Time-Warner or MCI, both active participants in this docket. Secondly, MFS ignores the fact that a small market share loss equates to a loss of contribution of many millions of dollars (Trimble Direct, pp. 12-13, Ex. 12, Table 4). If the Commission follows MFS' recommendation that it ignore the economic consequences upon GTEFL, the Commission will be shirking its responsibility under Florida law.

Also, setting the rates at TSLRIC is inconsistent with the recently enacted *Telecommunications Act of 1996*, Pub. L. No. 104-104 (Act). That Act established standards for states to follow in determining whether interconnection rates are just and reasonable for the interconnection of facilities and equipment. For rates to be just and reasonable under the Act, they:

> (A) shall be--
>
> > (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable), and
> >
> > (ii) nondiscriminatory, and
>
> (B) may include a *reasonable profit.*

Id. at §252(c)(1) (emphasis added). Pricing the unbundled loops at their long run incremental costs (whether at LRIC or TSLRIC) violates the newly enacted federal standard for pricing of unbundled network elements. First, pricing the unbundled loops at TSLRIC does not cover any of GTEFL's embedded costs in providing that loop. Secondly, pricing at TSLRIC denies GTEFL a reasonable profit as set forth in the statute.

Although reasonable profit is not defined in the Act, any such profit would be added to the price after the costs are fully recovered. This cost includes joint and common costs as well as general and administrative costs. That is not being done under any of the proposals set forth by MFS or the other ALECs. Indeed, their suggested price does not even meet the first threshold of covering costs under subsection 252(c)(1)(A), much less the second threshold of reasonable profit under subsection 252(c)(1)(B). MFS's preposterous claim that a cost of capital is really a profit (T. 136) and that joint and common costs are not really costs (T.139) makes no economic sense and should be summarily rejected.

Moreover, the Commission should not order deaveraged prices at this time as requested by MFS (Devine Reb., pp 10-12). Although deaveraged unbundled loop prices are appropriate in theory, they are not appropriate as long as GTEFL is precluded from rebalancing its rates. As explained by GTEFL witness Dennis Trimble:

> To a large degree I agree with Dr. Cornell, that all elements that the telephone company has should be . . . de-averaged. But they must be done in a very coordinated fashion. Unbundled loops should not be de-averaged without de-averaging retail rates. That puts enormous pressure and enormous opportunities or disopportunities on the incumbent LEC if that occurs; one is de-averaged, and the other is not.

(T. 432-33). As noted by Mr. Trimble, prices generally (both wholesale and retail) should be deaveraged based on density, distance and volume (T. 433). However, they must be deaveraged at the same time.

If unbundled rates are deaveraged and retail rates are not, the potential negative impacts upon GTEFL and its rural ratepayers are as obvious as they are significant. If ALECs pay deaveraged prices for an unbundled loop in low cost area, they could easily undercut the retail price of the incumbent LEC, which is charging higher statewide average rates in the same areas. The incumbent LEC will also be unable to effectively respond to the ALEC's prices without further stressing its financial integrity, because to do so would mean that the LEC will not be able to cover its costs in the subsidized rural areas. Furthermore, while deaveraging creates a negative impact on GTEFL, it opens "enormous" competitive opportunities for MFS and other ALECs (T. 432). If the ALECs are able to purchase deaveraged loops in a market where the LEC must charge statewide average prices, the ALECs could meet the LEC's price and maintain the high contributions because the ALECs have no obligation and little incentive to serve high cost areas.[4] In this case, the contribution would go directly to MFS' bottom line and to its shareholders.

B. MFS' Claim that GTEFL's Proposals Create a Price Squeeze is Without Merit.

MFS' allegation that GTEFL's proposed pricing creates a price squeeze is preposterous. In making this claim, MFS ignores the substantial revenues which it and other ALECs will generate from non-basic services such as high speed data services, vertical services, access charges and toll. In considering whether a price squeeze occurs, the Commission must view the customer on a total account basis with the customer as an economic entity. Viewing the customer as individual and distinct services leads to an improper conclusion (as is being reached by MFS).

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[4] If the price for unbundled loops is deaveraged, the deaveraged price charged to the ALECs would be significantly *more* than the LEC's average retail price in high cost areas (T. 137). Incredibly, MFS is not opposed to GTEFL charging an even higher rate in certain areas. MFS' position in this regard is directly contrary to its testimony that a price squeeze will be created. MFS' recommendation in favor of deaveraged rates signifies one of two possibilities. MFS has either no desire to ever serve high cost areas (so the alleged price squeeze will never materialize in these areas) or the potential for a price squeeze does not exist even in high cost areas because of the significant contribution generated by toll and other services.

Under rate of return regulation, these vertical services, toll and access charges were set at levels high enough to allow GTEFL to keep basic residential rates low throughout the state, even in those areas which are very costly to serve. Under the terms of GTEFL's regulatory compact with the State of Florida, GTEFL was able to price basic local residential service below cost because the company was able to make up the difference by pricing toll, access and discretionary services well above cost.

The same amount of contribution received by GTEFL from non-basic services will be available to the MFS. MFS witness Tim Devine testified that MFS intended to offer toll, vertical services, data services and all other services presently offered by incumbent LECs (T. 129-30). Mr. Devine also envisioned that MFS would offer services which are not presently offered by GTEFL, such as a global-centrex type service (T. 130). Mr. Devine also testified that MFS will charge IXCs for access to their loops, just like LECs (T. 129). He also stated that MFS will concentrate its initial marketing efforts upon "low cost, short distance, high density areas," which generate even more contribution (T. 127). Thus, it is clear that once MFS gets a customer to change from GTEFL, that customer brings with it the same high contributions currently received by GTEFL. The big difference is that while MFS will receive the same level of contribution, it does not share the same obligations as GTEFL, who must utilize this contribution to subsidize below cost residential rates throughout the state, including areas which are very costly to serve.

MFS witness Tim Devine (as well as the other ALEC witnesses) did not consider the additional revenues that would be generated over that loop when they testified about a price squeeze (T. 131). When faced with the question about other revenues, Mr. Devine all but admitted that a price squeeze would not occur, testifying:

> I would think that the total revenue would exceed the cost. *I mean, that's why we are getting into business.*

(T. 133; emphasis added). MFS is not getting into the local telephone business just to generate revenue sufficient to merely exceed costs. If the ALECs make as much contribution from discretionary services that GTEFL presently makes, the total revenue obtained from a unbundled customer loop will be nearly three times the proposed price of an unbundled loop.[5] This figure is also extremely conservative because the revenues shown are from an average business customer (T. 361). The customers targeted by MFS will generate even more contribution than the average presented by Mr. Trimble (Ex.12, Table 1).

When all revenues are considered, GTEFL's proposed rate of $23.00 will be dwarfed by the amount of contribution which MFS receives from toll, access or vertical services. Again, the Commission must view the customer on a total account value basis with the customer as an economic entity and not as an individual service on a stand alone basis. Considering all contribution sources, GTEFL's proposed rate will not come close to creating a price squeeze. In fact, the opposite is true. It is the incumbent LEC who will be placed at a competitive disadvantage. The incumbent LECs' existing price structure

[5] Exhibit 12, Table 1. This is shown by comparing the total revenue generated shown on the last line of "Revenue (per Line)" to GTEFL's proposed special access rate of $23.00.

affords MFS and other ALECs with immense competitive advantages, as are described below.

Advantage No. 1: MFS and other ALECs can easily undercut GTEFL's price and still maintain significant margins over cost.

MFS and other ALECs can easily compete with GTEFL on price and still maintain significant margins over cost. As shown on Exhibit 12 (Table 1), the Commission has approved rates which greatly exceed the long run incremental cost of those services. Under traditional rate of return regulation, these rates were set at high levels in order to keep basic local service rates as low as possible (Trimble Direct, pp. 8-9). Therefore, assuming that MFS is as efficient as GTEFL, MFS could meet or beat GTEFL's price and still make a substantial margin over these costs.

Advantage No. 2: Substantial margins go to the MFS' bottom line.

As noted above, MFS and other ALECs will have the capability to earn substantial margins over cost and still beat the incumbent LECs on price. However, these increased margins will go to the ALECs' bottom line -- not to keep other rates low. Unlike GTEFL, MFS has no obligation to use the contributions to keep rates low in high cost areas. Unlike GTEFL, MFS has the option of merely choosing not to serve areas where it is not economical to do so. Unlike GTEFL, the substantial margins generated by non-basic services are gravy to MFS. To GTEFL, these contributions are essential to GTEFL meeting its carrier of last resort and universal service obligations.

Advantage No. 3: Incumbent LECs will not be able to effectively respond because of their obligation to support low basic rates throughout the state.

Not only will MFS and other ALECs garner immense profits, they will be protected from competitive responses by GTEFL. As carrier of last resort, GTEFL must serve all customers at the same rate throughout its serving territory. GTEFL uses the substantial margins obtained from toll, access and discretionary services to meet its obligation to keep the rates low throughout the state. Competition will not lessen the scope or nature of GTEFL's obligation. As such, GTEFL will be placed at a competitive disadvantage because neither MFS nor other ALECs will have that obligation.

Advantage No. 4: MFS and other ALECs will be able to compete even if less efficient than GTEFL.

MFS and other ALECs are provided incentives to compete despite being inefficient. The high levels of contribution encourage inefficient ALECs to enter the market. If it costs an ALEC twice as much to provide the toll, access or other services, the ALEC could still undercut GTEFL's prices and maintain a substantial margin above costs.

Advantage No. 5: For wholesale services, MFS and other ALECs do not have the joint and common costs incurred by GTEFL.

The margins generated for toll, access, and discretionary services also support the incumbents LECs' shared costs of its network in providing those services. MFS claims that the incumbent LEC has an advantage because its ubiquitous network is already in place. (Devine Direct, pp. 12-13). However, the ALECs refuse to acknowledge that this ubiquitous network involved significant capital investment and maintenance costs by the

LEC. Yet, if prices are set at LRIC or TSLRIC, the ALECs get the benefit of this extensive network at fire sale prices.

C. Forcing the Loss of Contribution on GTEFL Constitutes an Impermissible Taking of GTEFL's Property.

There is no dispute that GTEFL, by being required to sell unbundled facilities to MFS and other ALECs, will be required to forego recovery of and on investments made pursuant to a historical regulatory compact entered with the State of Florida. Unless the Commission permits comprehensive and immediate recovery, it will now place GTEFL in a position where it cannot recoup lost contribution. This action constitutes an unconstitutional taking of GTEFL's property prohibited by the United States and Florida Constitutions.

1. The State has Violated Its Regulatory Compact with GTEFL by Requiring the Unbundling of Loops Without a Recovery of GTEFL's Investment and has Violated the Takings Clause by Depriving GTEFL of the Opportunity to Earn a Reasonable Return on its Investment.

GTEFL was induced by a historical regulatory compact to make substantial specialized investments in regulated telecommunications facilities and undertake service obligations with the understanding that GTEFL would recover its investment as well as the costs of services rendered. Prior to January 1, 1996, GTEFL held a local monopoly created by Section 364.335 and was rate base regulated. Under the Prudent Investment Rule as described by the Supreme Court, GTEFL is entitled to be "compensated for all prudent investments at their actual cost when made (their "historical" cost) irrespective of whether individual investments are deemed necessary or beneficial in hindsight." *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 309 (1989). *See also*, *FPC v. Hope Natural Gas Co.*, 320 U.S. 591 (1944). These investments and costs were previously recovered through rate mechanisms and control of entry into the telecommunications field by the Commission. This constituted an express regulatory compact between the Commission and GTEFL.

Upon enactment of the revisions to Chapter 364 of the Florida Statutes, the state has abandoned the regulatory compact by opening the local exchange market to competition. Furthermore, MFS and the other ALECs have recommended prices for unbundled loops which, if adopted, will deny GTEFL the opportunity to recover its investment previously made under that compact. In fact, the products and services which GTEFL sold at artificially high prices will now be sold by GTEFL's competitors using the company's unbundled wholesale services to provide those consumer services. While the state previously permitted recovery of these investments, the Commission is now poised to take action which "jeopardizes the financial integrity" of GTEFL . *Duquesne* at 312.

Unless the Commission permits immediate rate relief in some form, any rate the Commission adopts will be "inadequate to compensate current equity holders for the risk associated with their investments" made under rate of return regulation. *Id.* Precluding an adequate recovery of GTEFL's previous investment constitutes a regulatory taking of property without just compensation. U.S. Const., Amend. V and XIV; Fla. Const., art. 10, §6. *See also*, *Federal Power Commission v. Hope Natural Gas Company*, 320 US 591, 605 (1944) (commissions must set rates which are just and reasonable so as to "enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed."); *Bluefield Water Works and Improvement Company v. Public Service Commission*, 262 US 679, 692 (1923) (directing that rates must be set so as to allow a return that is equal to "investments on other business undertakings which are attended by corresponding risks and uncertainties."); *Penn Central Transportation Co. v. City of New York,* 438 U.S. 104, 125 (1978) (relevant considerations in determining whether an unconstitutional taking has taken place includes the economic impact of the regulation, the extent to which the regulation has interfered with distinct investment-backed expectations, as well as character of the government action).

GTEFL presented unrefuted testimony at the hearing of this docket which establishes that an unconstitutional taking will occur under the above cases unless GTEFL is entitled to make an adequate recovery of its investment through rate rebalancing or some other mechanism. GTEFL witness Dennis Trimble testified about the devastating economic impact to GTEFL of improper pricing of unbundled services. Mr. Trimble identified a million dollar loss of contribution with but a small percentage (10%) of market share loss. (Trimble Direct, pp. 12-13). This was a conservative estimate given the fact that AT&T witness Mike Guedel acknowledged AT&T's plans to capture 30% of the local exchange market (T. 323). Using AT&T's estimate, GTEFL's loss will exceed million dollars. The magnitude of these losses to investors can also be expressed in lost return on investor equity. Using the 10% and 30% market share figures, GTEFL's investors will suffer a loss of return ranging from to basis points. Clearly these losses prove a taking without just compensation under the United States and Florida Constitutions.

2. Setting Rates at Levels Which Do Not Recover Their Total Costs Constitutes A Taking of Property Without Just Compensation.

MFS has argued that GTEFL must price its services at its LRIC levels, requiring GTEFL to forego recovery of all service-specific incremental volume insensitive costs as well as shared common costs. MFS noted that GTEFL makes money "if you add up all the components with switched access and vertical features . . . and especially with GTE's announcement to get into long distance" (T.129). MCI witness Nina Cornell also claims that joint and common costs must be recovered from other services (Cornell Direct, pp. 7-8). If the Commission adopts these positions, such actions will constitute an unconstitutional taking of GTEFL's property.

Neither this Commission nor any other governmental agency is permitted to impose confiscatory rates on one line of a company's business simply because the company theoretically can afford those losses by generating additional revenue on other lines of business. Such a notion would permit the government to impose below-cost pricing on any profitable company. For instance the government could force Microsoft to sell software to competitors at a loss, on the ground that it made "enough" selling Windows 95 to others. Regulators could require Ford Motor Company to sell small cars to the needy at a loss on the ground that such losses are more than "offset" by profits made by the company on popular luxury cars.

Justice Holmes, speaking for a unanimous court, rejected this theory in *Brooks-Scanlon Co. v. Railroad Commission*, 251 U.S. 396 (1920). In that case, the Railroad Commission had sought to justify a below-cost rate for one company's railroad line on the ground that the company more than made up for the loss through its profits on its related timber and lumber business. The Commission urged that "although the railroad showed a loss, the test of the plaintiff's rights was the net result of the whole enterprise -- the entire business of the corporation." *Id.* at 399. The Supreme Court rejected this theory in unequivocal terms:

> A carrier cannot be compelled to carry on even a branch of business at a loss, much less the whole business of carriage. . . . The plaintiff may be making money from its sawmill and lumber business but it no more can be compelled to spend that than it can be compelled to spend any other money to maintain a railroad for the benefit of others who do not care to pay for it.

Id. The Court held that the plaintiff could not be required to offer such services "at a loss." *See also*, *Calfarm Ins. Co. v. Deukemejian*, 48 Cal.3d 805 (1989) (law requiring certain insurance rates to be lowered by 20% was held to be unconstitutional precisely because it looked to the "financial position of the company as a whole" and not merely to the business affected by the new rates); *State of North Carolina ex rel Utilities Commission v. Lee Telephone Co.*, 263 N.C. 702, 140 S.E.2d 319 (1965) (held that the reasonableness of the rates to be fixed by the state must be decided with reference exclusively to what is just and reasonable for the domestic business in that state).

As held by the Court in *Brooks-Scanlon*, as well as the other state cases cited above, mandatory below-cost pricing on a particular line of business (i.e. the sale of unbundled loops) is unconstitutional even if the company is able to make up those losses from revenues generated from other services. Like other companies, GTEFL hopes to make money on its competitive services. But, like other companies, it cannot be required to spend revenue generated from such services in order to subsidize other services provided to competitors below cost.

3. The Interconnection of an Unbundled Loop to a Competitor's Network Represents a Physical Taking Which Must Be Adequately Compensated.

The interconnection of an unbundled loop from GTEFL to MFS's network constitutes a government-ordered permanent physical invasion of the property of GTEFL. Mandatory interconnection and unbundling by definition provide physical access to GTEFL's tangible property. This interconnection allows MFS to move its traffic over GTEFL's network which is then physically invaded by the bits and bytes transmitted by MFS. The physical movement of bits of information across telephone wires constitutes a physical invasion of GTEFL's private property. As such, compensation for this physical taking must be appropriate and compensatory under the Supreme Court's 1982 decision in *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982). Unlike the balancing analysis in a regulatory takings case, a permanent physical occupation is a government action of such an intrusive character that it is a taking without regard to other factors that the court may ordinarily examine. *Id.* at 426-436. The appropriate compensation for a physical taking is that which is necessary to compensate the property owner for the full opportunity cost of the physical invasion.

D. **GTEFL's Proposed Rates for Other Unbundled Elements are also Just and Reasonable and Should be Approved.**

Although much of the debate in this docket related to GTEFL's proposed rate for the 2-wire unbundled loop, GTEFL has also proposed rates for several other unbundled elements which should be approved by the Commission (Ex. 11, pp. 81-82). As with its proposed rate for the 2-wire loop, GTEFL has attempted to use existing tariffed rates whenever possible. As such, GTEFL has utilized the existing tariffed rate for a 4-wire link ($33.00), a 2-wire ISDN digital grade link ($23.00) and a 4-wire DS-1 digital grade link ($250.00).

For ports, GTEFL is proposing to charge $6.00 per month for 2/4 wire ports and 2-wire analog DID ports, $20.00 for a 2-wire ISDN digital port, $60.00 per month for a 4-wire ISDN DS-1 digital port and $350.00 per month for an ISDN DS-1 digital port. Additionally, port usage charges will also be applicable. The port usage charges are $0.015 per completed call and per minute for peak usage and $0.01 per completed call and per minute for off-peak usage (Ex. 11, p. 82). These usage charges are the same as those currently tariffed for shared tenant service (Trimble Direct, pp. 11-12).

GTEFL is also proposing non-recurring service order charges of $91.25 for the initial order and $26.80 for additional services. GTEFL is also proposing cross connection charges of $0.83 for DS0 connection, $3.50 for a DS1 connection and $26.51 for a DS3 connection.

Finally, GTEFL is seeking to impose an implementation recovery charge of $4.16 per unit order to recover the one-time implementation costs of 2.2 million associated with local competition (Trimble Direct, p. 13-14). These costs will be incurred by GTEFL for a one-time systems enhancement to handle ALEC ordering, ALEC processing expenses and other billing and ordering system requirements (Trimble Depo., Ex. 11, p. 14). Even Nina Cornell acknowledged that such costs will be caused by the entry of new carriers into the local market (T. 277). As the cost causer, the ALECs should be responsible for paying this charge.

Issue 4: What arrangements, if any, are necessary to address other operational issues?

Position: GTEFL believes any additional operational issues that may arise are best addressed through ongoing negotiations with MFS. As such, GTEFL is not seeking any relief from the Commission on this issue.

Issue 5: To what extent are the non-petitioning parties that actively participate in this proceeding bound by the Commission's decision in this docket as it relates to Sprint-United/Centel and GTEFL?

GTEFL Summary of Position: ** Although GTEFL contends that the legislature intended LECs to negotiate individual contracts with individual ALECs, intervening (although non-petitioning) ALECs would be precluded from relitigating the same issues under the doctrine of *res judicata*. That doctrine applies to subsequent administrative hearings in which identical parties litigate the same issues previously litigated. **

GTEFL Position: GTEFL contends that the legislature intended LECs to negotiate individual contracts with individual ALECs. As such, as long as the LECs do not unreasonably discriminate against ALECs, they could enter agreements containing potentially different rates, terms and conditions, depending upon the particular needs of the ALEC. Thus, the non-petitioning parties would not necessarily be bound by the rates approved in this docket.

However, intervening (although non-petitioning) ALECs would be precluded from relitigating the same issues under the doctrine of *res judicata*. That doctrine applies to subsequent administrative hearings in which identical parties litigate the same issues previously litigated. *See e.g.*, *Thomson v. Department of Environmental Regulation*, 511 So.2d 989 (Fla. 1987). Thus, although non-petitioning parties would still have the right to negotiate unbundling arrangements regardless of the outcome of this proceeding, they would not be permitted to relitigate the same issues against the same party at some point in the future (assuming no material change in circumstances). Non-petitioning parties should not be entitled to two bites at the apple on the same issue. If those parties lose an issue, they many not raise the same issue at later time merely by filing a petition.

Respectfully submitted on April 5, 1996.

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