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August 16, 1996

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

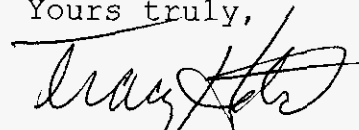
Docket No. 960847-TP

Dear Mrs. Bayo:

Enclosed for filing in the above referenced docket are an original and fifteen (15) copies of the Direct Testimony of Mike Guedel, Joseph Gillan, Art Lerma, Joseph P. Cresse, David L. Kaserman, Don J. Wood, Ray Crafton, William J. Carroll, L. G. Sather and Ronald H. Shurter.

Copies of the foregoing are being served on all parties of record in accordance with the attached Certificate of Service.

Yours truly,


Tracy Hatch

Attachments

cc: J. P. Spooner, Jr.
Parties of Record

- ACK _____
- AEA _____
- AFB _____
- CFR _____
- CPD _____
- DPD _____
- CPD _____
- EPD _____
- LEP 3
- LEP 5 + orgs
- CPD 1
- RFP _____
- SEC 1
- WAS _____
- OTH _____



08673-96

CERTIFICATE OF SERVICE

DOCKET NOS. 960847-TP

I HEREBY CERTIFY that a true copy of the foregoing has been furnished by U. S. Mail or hand-delivery to the following parties of record this 16th day of August, 1996:

Beverly Menard, Director
c/o Ken Waters
GTE Florida Incorporated
106 E. College Ave., Suite 1440
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Tracy Hatch

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DIRECT TESTIMONY OF
ART LERMA
AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 960847-TP

Q. PLEASE IDENTIFY YOURSELF.

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

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND AND EXPERIENCE.

A. In 1974, I received a Bachelor of Arts degree in Mathematics from Trinity University in San Antonio, Texas. In 1994, I received a Master of Business Administration from St. Edwards University in Austin, Texas with a concentration in General Business and Telecommunications Management.

Q PLEASE DESCRIBE YOUR CURRENT EMPLOYMENT, THE SCOPE OF YOUR RESPONSIBILITIES, AND YOUR PRIOR WORK EXPERIENCE.

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

$$\begin{array}{rcl}
 \text{Expense} & \times & \underline{\text{Direct local costs that will be avoided}} \\
 & & \text{Total local costs minus total local indirect costs}
 \end{array}$$

15
 16
 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:

$$\frac{\text{General Support facilities investment}}{\text{Total Telephone Plant-in Service}} \times \frac{\text{Direct costs that will be avoided}}{\text{Total local costs minus total local indirect costs}}$$

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.

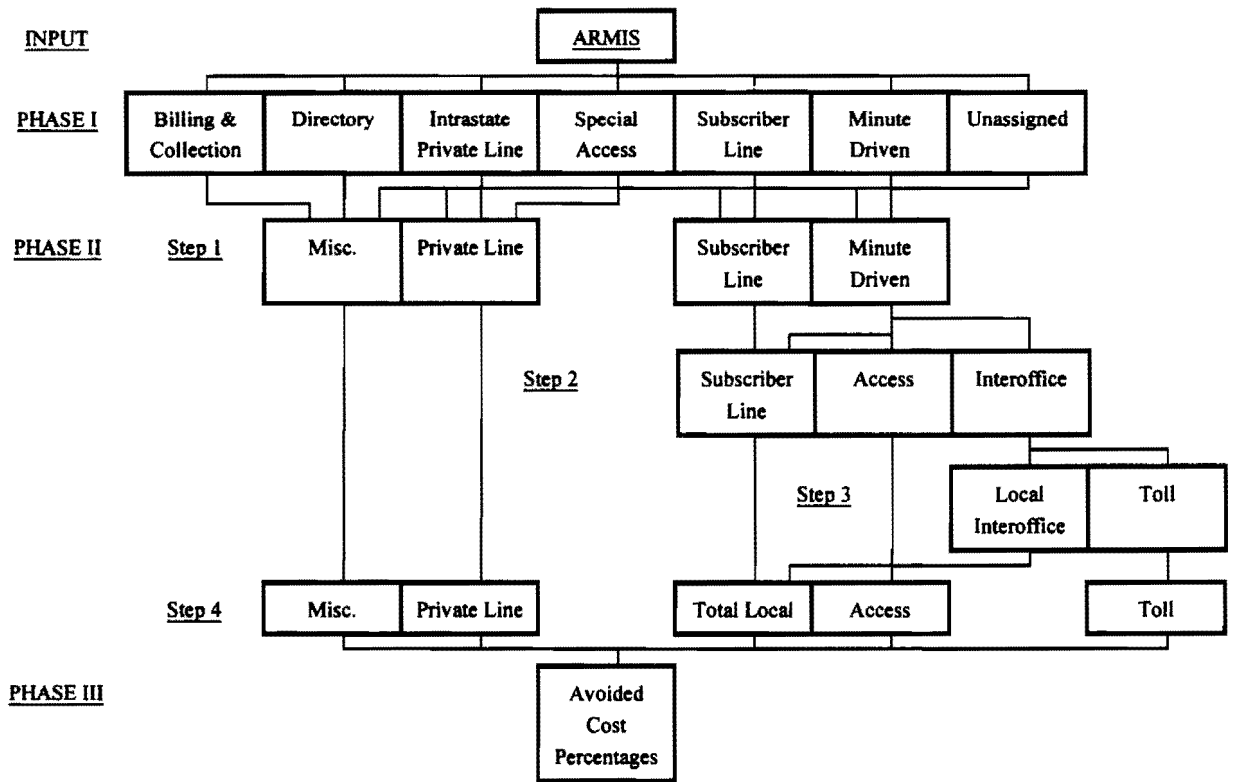
24

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

1

2 A. Yes, it does.

FLOW OF INFORMATION WITHIN AT&T'S
AVOIDED COST MODELING PROCESS



TREATMENT OF ARMIS DATA

Revenue

ARMIS data are provided in sufficiently detailed sub account classifications to allow for direct assignment of revenues to each business unit except for Network Access Interstate which is distributed to Interstate IX & EU LD and Minute Driven based on a Switched Access Factor (see Exhibit AL3). The assigned revenues for each business unit will be used as the denominator in the wholesale discount percentage rate calculation; therefore the proper assignment is key to the reasonableness of the discount rate. Further, the revenues used in the denominator are (must be) the same set of services that the discount rate will be applied to.

<u>ARMIS Revenue Category</u>	<u>Business Unit Assignment</u>
Private Line: Local Service	Private Line
Public Telephone: Local Service	Miscellaneous
All Other Local Service Revenues	Local
End User Access Charges (Subscriber Line Charges)	Access
Interstate Special Access	Private Line
Interstate Switch Access	Access
Intrastate Access	Access/PL
Toll Revenues (Long Distance)	Toll
Billing & Collection Revenue	Miscellaneous
Directory Revenue	Miscellaneous

Intrastate Access revenue is disaggregated to the Access and Private Line Business Units using the Switched Access Factor (see Exhibit AL3).

Interconnection/Access

Any expense incurred by the incumbent LEC to interconnect with another LEC for the completion of intraLATA traffic that is recorded to the interconnection/access expense line is processed through the Model and assigned to Toll.

Uncollectibles

Uncollectible revenues for all products are recorded and reflected on a single line in the ARMIS reports, therefore assignment to each functional category is required. The ARMIS data for private line services are used to directly assign uncollectibles to the Private Line business unit. The Model simulates an uncollectible amount for toll service by multiplying toll revenues by an uncollectible rate developed by AT&T based upon

experience. The Model assumes no uncollectibles for the Access line of business. The remaining balance in the Uncollectible Revenue account is assigned to the Local business unit.

Depreciation

Phase I - Functional Categorization

In Phase I, the distribution of Depreciation line items is generally determined by the underlying investment. Depreciation is distributed to the various functional categories in proportion to the underlying investments functional category assignment. Equal Access and Operator Systems Depreciation are directly assigned to Minute Driven. Support Depreciation is distributed in accordance with the Big Three Factor which represents the relative functional category expenses of network operations, sales and service. Other Depreciation is distributed based upon the relative functional category subtotals of Depreciation before Other and less Equal Access. Lastly, Interstate Special is directly assigned for all Depreciation line items based on the 43-04 Special Access column.

Phase II - Line of Business Assignment

In Phase II Step 1, Unassigned is distributed based upon the relative percentages of the previously distributed depreciation expenses to Miscellaneous, Private Line, Subscriber Line and Minute Driven for all Depreciation line items except Switching and Information Originating/Terminating. Switching is distributed to Subscriber Line and Minute Driven based on a Subscriber Switching Factor (see Exhibit AL3). Information Originating/Terminating Unassigned is assigned to Miscellaneous. In Step 2, Equal Access is assigned to Access, Operator Systems is assigned to Interoffice, Switching is distributed to Subscriber Line, Access and Interoffice based on the Switching Minute Driven Factor (see Exhibit AL3) and all other line items are distributed to Access and Interoffice based on the Trunking Minute Driven Factor (see Exhibit AL3). In Step 3, Switching Interoffice is distributed to Local Interoffice and Toll based on the Switching Interoffice Factor (see Exhibit AL3) and all the other line items' Interoffice except Equal Access are distributed by the Trunking Interoffice Factor (see Exhibit AL3) to Local Interoffice and Toll. Equal Access is directly assigned to Access.

Network

Phase I - Functional Categorization

Network Central Office Operator Systems, Switching, Circuit, Information Originating/Terminating and Cable & Wire Facilities line items are distributed to the various functional categories in proportion to the underlying investments functional category assignment. Network Support is distributed in accordance with the Big Three Factor which represents the relative functional category expenses of network operations, sales and service. Network Operations and Network Other Property, Plant & Equipment

is distributed based upon the relative functional category subtotals of Composite Investment which includes Cable & Wire Feeder, Information Originating/Terminating, Circuit, Switch and Operator Systems. Interstate Special is directly assigned for all Network line items based on the 43-04 Special Access column. Lastly, Call Completion,¹ Directory Assistance² and Published Directory are assigned respectively to Minute Driven, Subscriber Line and Directory categories.

Phase II - Line of Business Assignment

Network expenses, identified in Phase I, are distributed to the various Business Units through the use of six factors in a three step process. In Step 1, all Network expenses with the exception of Network Switching and unassigned are distributed to the Miscellaneous, Private Line, Subscriber Line, and Minute Driven categories. Unassigned expenses are distributed to functional categories based on the ratio of functional category's total Network expense to total company Network assigned expense from Phase I. Network CO Switching is assigned to Private Line and distributed between Subscriber Line and Minute Driven categories through the use of the Subscriber Switching Factor (see Exhibit AL3).

In Step 2, Network Circuit, Cable & Wire Facilities, Equal Access, Other Plant Property and Equipment are distributed from Minute Driven to the Access and Interoffice categories through the use of the Trunking Minute Driven Factor (see Exhibit AL3). Operations- Power, Network Administration, Testing, Plant Administration, Engineering and Support are distributed from Minute Driven to the Access and Interoffice categories using a Hybrid Switching Trunking Methodology (see Exhibit AL3). Additionally, Network CO Switching is allocated to Subscriber Line, Access and Interoffice categories from Subscriber Line and Minute Driven by using a Switching Minute Driven Factor (see Exhibit AL3). In Step 3, Network Circuit, Cable & Wire Facilities, Equal Access, Other Property and Plant, Power, Network Administration, Testing, Plant Administration, Engineering and Support expense categories are distributed from Interoffice to Local Interoffice and Toll categories using the Trunking Interoffice Factor (see Exhibit AL3). In one other calculation CO Switching is similarly distributed from Interoffice to Local Interoffice and Toll using the Switching Interoffice Factor (see Exhibit AL3).

¹ Line item Call Completion is equal to Tot Tel Op LN 7060 minus the Directory Assistance line item.

² Line item Directory Assistance is zero if there isn't any investment in Total Auxiliary Service Boards - LN 1154. If there is an investment and call completion LN 7010 is zero, then line item Directory Assistance is the percent of Total Auxiliary Service Board Equipment to Total Operator Systems Equipment LN 1170 times Total Telephone Operator expense LN 7060. If there is an investment and call completion is not zero, Directory Assistance is equal to Intercept LN 7020, Directory Assistance LN 7030 and Other LN 7040 added together.

Marketing, Sales & Advertising

Phase I - Functional Categorization

Product Management, Sales and Advertising

Product Management, Sales and Advertising line items received their proportional share of Marketing 43-04 Special Access column LN 7000 for their Interstate Special functional category assignment. The remainder of each of these line items is assigned to the Unassigned category.

Service Order Provisioning

Customer Operations Service Order Provisioning is distributed as delineated below: Interexchange Carrier Service Order Processing Expenses are distributed as follows: PL & Special LN 7147 Interstate column is assigned to the Interstate Special category; Interstate IX & EU LD is zero if the associated investment in Total Special Non-WideBand equipment LN 1243 is zero, otherwise it is Total IXC Service Order Expense LN 7150 Subject to Separations column minus the Interstate Special assignment above times the ratio of State PL Weighed Average Contacts LN 7141 divided by Total Weighted Average Contacts LN 7140; Total IXC Service Order Expense LN 7150 Subject to Separations column less the two prior assignments is assigned to the Minute Driven category. Order Processing - End User is directly assigned from LN 7092, PL & Special Service Order Processing, Total Intrastate Column; Interstate Special Access is LN 7092 Total Interstate; Subscriber Line functional category is lines 7089 and 7090, Local Service Order Processing and Presub Service Order Processing, respectively; Minute Driven functional category is LN 7096, Total Service Order Processing, less the expenses identified above.

Other Customer Operation

The LN 7300 Other Cust Srv Special Access column is assigned to Interstate Special category, the Billing and Collection column is grossed up by the ratio of LN 4031 B&C Revenue Subject to Separations column to the Total Interstate column and assigned to the Billing and Collection category and LN 7300 Other Cust Srv Subject to Separations column minus the two prior assignments is assigned to the Unassigned category.

Phase II - Line of Business Assignment

Marketing expenses from Phase I are distributed or directly assigned to the functional categories in three steps. In Step 1, Sales, Product Management, Advertising, IXC and EU Order processing and Other Customer Service/Operations identified in the Phase 1 functional categories with the exception of unassigned functional category are assigned to the Miscellaneous, Private Line, Subscriber Line and Minute Driven categories. The Unassigned category is distributed to the four categories based upon the relative

percentages of the previously distributed Marketing, Sales & Advertising; Order Processing and Other Customer Operation expenses. In Step 2, Order Processing IXC and Other Customer Operations are directly reassigned from Minute Driven to the Access BU. In the same step, Order Processing-EU is directly reassigned from Minute Driven to the Interoffice category. Sales, Product Management and Advertising is distributed from Minute Driven to Access and Interoffice based on percentage of Order Processing and Other Customer Operations in each category. In the final step, Sales, Product Management, Advertising, and Order Processing-EU are reassigned from Interoffice directly to the Toll BU.

Billing

Interexchange Carrier Bureaus and LEC Billing

Phase I - Functional Categorization

In Phase I, the Interexchange Billing related to Message Processing, Insertion/Postage, Inquiry and Collection is distributed between the IX and LEC.

Phase II - Line of Business Assignment

IX Message Processing is all assigned to the Billing and Collection category and is the Total Interstate column LN 7236, Total Message Processing grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. Total Message Processing Subject to Separations column LN 7236 less the IX Message Processing Total is assigned to LEC Message Processing Minute Driven.

IX Insertion Processing is all assigned to the Billing and Collection category and is the Billing & Collection column LN 7283, All Other Cat 2 less Interstate column LN 7236, Total Message Processing grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. IX Insertion Processing is subtracted from Expense Subject to Separations column LN 7259, Total Other Billing and Collection to arrive at LEC Insertion Processing. LEC Insertion Processing is distributed to Subscriber Line and Minute Driven based on the ratio of EX & Semi Users LN 7244 and MSG Toll Users LN 7241 respectively to Total Current Users LN 7240. The remainder is distributed to Intrastate EU Local and Intrastate IX & EU LD based on the relative composite investment in both of these categories.

IX Inquiry is all assigned to the Billing and Collection category and is Total Bill Inq LN 7132 Interstate column plus Total IC Bill Inq Interstate column LN 7190 divided by (Total Bill Inq LN 7132 Interstate column plus Total IC Bill Inq Interstate column LN 7190 plus Total EU Pay & Col Interstate column LN 7112 plus Total IC Pay & Col Interstate column LN 7170) grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. This amount is subtracted from the sum of Total Billing Inquiry Subject to Separations column LN 7132 and Total IC Bill Inquiry Subject to Separations column

LN 7190 to arrive at LEC Inquiry Processing. Part of LEC Inquiry Processing is allocated to Subscriber Line based on the ratio of # Other WAC (Weighted Average Contacts) LN 7126 to #Total WAC LN 7120. Another part to Intrastate EU Local and Intrastate IX & EU LD based the ratio of #State PL WAC LN 7121 to #Total WAC LN 7120 and then their relative percentage of composite investment for Intrastate EU Local and Intrastate IX & EU LD. Interstate Special is assigned a part equal to Total Cat 1 Special Access column minus PL & Special Total Interstate column from lines 7092, 7147 and 7167. Minute Driven is assigned the remaining part.

IX Collecting is all assigned to the Billing and Collection category and is the Total Cat 1 Billing and Collection column LN 7220 minus (IX Inquiry determined above before the gross up) grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. This amount is subtracted from the sum of Total EU Pay & Col Subject to Separations column LN 7112 and Total IC Pay & Col Subject to Separations column LN 7170 to arrive at LEC Collecting. LEC Collecting is distributed as follows: PL & Special Total Interstate column 7167 is assigned to Interstate Special. Subscriber Line is assigned LEC Collecting Total times the ratio of #Local Bill Rev LN 7105 to #Total Bill Rev LN 7100. Intrastate EU Local and Intrastate IX & EU LD are distributed from LEC Collecting Total based the ratio of #State PL Billed Rev LN 7101 to #Total Bill Rev LN 7100 and then their relative percentage of composite investment for Intrastate EU Local and Intrastate IX & EU LD. The remaining LEC Collecting Total is assigned to Minute Driven.

Carrier Access Billing System

Phase I - Functional Categorization

In Phase I, the Carrier Access LN 7281 Special Access Column is assigned to the Interstate Special category. Carrier Access LN 7270 Subject to Separations column minus the Interstate Special assignment is distributed to the Intrastate IX & EU LD and Minute Driven categories based on the relative percentages of composite investment in the Intrastate IX & EU LD.

Phase II - Line of Business Assignment

In Phase II, Unassigned is distributed based upon the relative percentages of the previously distributed billing expenses to Miscellaneous, Private Line, Subscriber Line and Minute Driven. Minute Driven is assigned to the Toll BU.

Coin Collection/Administration

Phase I - Functional Categorization

In Phase I, the Coin Collection/Administration is assigned to Unassigned.

Phase II - Line of Business Assignment

For all Billing Line Items, in Phase II, Step 1, Coin Collection/Administration Unassigned is assigned to Miscellaneous. In Step 2, Minute Driven for CABS is assigned to Access and all LEC Billing Items are assigned to Interoffice. In Step 3, all LEC Interoffice is assigned to the Toll BU.

G &A

Corporate Operations

Phase I - Functional Categorization

In Phase I, the Corporate Operations Special Access column LN 7334 and the Billing and Collection Column LN 7334 grossed up by the ratio of B&C Revenue Subject to Separations column to the B&C Revenue Total Interstate column are assigned to Corporate Operations line items based on their relative proportions of Corporate Operations subtotal. All the other functional categories except Unassigned receive a distribution based on the Big Three Factor. Unassigned receives the remaining undistributed portion of the line items. Corporate Operations items were distributed by Big Three in Phase I in total as well as for the Information Management line specifically. Lastly, Phase I is adjusted by moving all line item totals except Information Management to Unassigned.

Phase II - Line of Business Assignment

In Phase II, the Network, Billing and MS&A subtotals are used to determine percentages for distributing Unassigned to Miscellaneous, Private Line, Subscriber Line and Minute Driven; the Minute Driven column to Access and Interoffice categories; and the Interoffice column to Local Interoffice and Toll categories.

Operating Taxes

Phase I - Functional Categorization

In Phase I, the Total Other State & Local LN 8005 Special Access column is assigned to the Interstate Special category. Direct Other State & Local LN 8002 Subject to Separations column and All Other State & Local LN 8003 Subject to Separations column minus the Interstate Special category assignment is assigned to the Unassigned category.

Phase II - Line of Business Assignment

In Phase II, the Network, Billing and MS&A subtotals are used to determine percentages for distributing Unassigned to Miscellaneous, Private Line, Subscriber Line and Minute Driven; the Minute Driven column to Access and Interoffice categories; and the

Interoffice to Local Interoffice and Toll categories.

Investment

Phase I - Functional Categorization

Net Investment serves as a basis for identifying the Phase III Rate-of-Return and FIT Gross-Up statistics. In Phase I, account specific Gross Investment data are obtained from the ARMIS 43-04 report and allocated to the Billing and Collection, Directory, Interstate Private Line (Intrastate EU Local and Intrastate IX & EU LD), Special Access, Subscriber Line, Minute Driven or Unassigned functional categories.

The various classes of investment are either assigned or distributed based on the use of the underlying investment or of related investment from a cost causative perspective or failing that are based upon a general distribution approach such as the Big Three where General Support Facilities are involved for example or such other prior distributions as are appropriate as a basis for the current distribution.

Information Originating/Terminating

The underlying investment for Information Originating/Terminating is assigned as follows:

- Subscriber Line receives LN 1440 Tot IOT Equipment less Special Access and an assignment to Intrastate EU Local PL.

Central Office Equal Access

The underlying investment for Central Office Equal Access is assigned as follows:

- Minute Driven less Special Access receives LN 30.

Central Office Operator Systems

The underlying investment for Central Office Operator Systems is assigned as follows:

- Minute Driven less Special Access receives LN 1170.

Central Office Switching

The underlying investment for Central Office Switch is assigned as follows:

- Minute driven receives Direct Message 36, LN 1201 and 1211; and Joint 36, LN 1202 and 1212; and Direct PL 36 LN 1200 and 1210 less Special Access.

Cable & Wire Facilities

The underlying investment for C&WF is assigned as follows:

- Subscriber Line receives LN 1455 Sub/Common Line.
- Intrastate EU Local receives less Special Access LN 1454 Private Line WATS, LN 1470 Nonwideband Private Line and LN 1480 Wideband Private Line.
- Minute Driven receives LN 1522 Joint Message, LN 1497 through 1500 Direct/Joint Msg and LN 1470 through 1471 Direct/Joint Message.
- Intrastate IX & EU LD receives less Special Access LN 1496 Direct Private Line.

Central Office Circuit

The underlying investment for Central Office Circuit is assigned as follows:

- Minute Driven receives LN 1231 Direct Message 36, LN 1232 Joint 36, LN 1338 Direct Message 36, LN 1338 Joint 36, LN 1391 Direct Message 36 and LN 1392 Joint 36.
- Subscriber Line receives LN 1275 Sub/Common Line.
- Intrastate EU Local receives less Special Access LN 1220 Direct PL 36, LN 1230 Direct PL 36, LN 1250 Direct PL 36 and LN 1274 PL/WATS 36.
- Intrastate IX & EU LD receives less Special Access LN 1320 Direct PL 36 and LN 1336 Direct PL 36.
- Special Access also receives LN 1280 Direct PL 36 and LN 1350 Direct PL 36.

Other investment categories are assigned to functional categories as follows:

<u>Title</u>	<u>Distributing Algorithm</u>	<u>43-04 LN</u>
General Support Facilities	Big Three	1004
Capital Leases:GSF	Big Three	2001
Capital Leases:Switch	Switching Investment	2003
Capital Leases:Operator Systems	Operator Systems Investment	2005
Capital Leases:Circuit	Circuit Investment	2007
Capital Leases:IOT	IOT Investment	2009
Capital Leases:C&WF	Investment	2011
Capital Leases:Other	Capital Lease:GSF	2013
Leasehold Improvements	Big Three Factor	2070
Intangibles	TPIS Less Intangibles	2160

Other Plant:PHFTU	Telephone Plant in Service	2190
Other Plant:TPUC Short	Telephone Plant in Service	2191
Other Plant: TPUC Long	Telephone Plant in Service	2192
Telephone Plant Adjustment	Telephone Plant in Service	2193
Inventories and so on	C&WF Investment	2221

Once the Gross Investment has been distributed, the Reserves for Accumulated Depreciation, Amortization and Deferred FIT are distributed in a similar fashion resulting in Net Investment by functional category.

Phase II - Line of Business Assignment

In Phase II the resulting Net Investment dollars are then redistributed into the five distinctive lines of business.

In Step I , the Unassigned portion is distributed based on the already distributed relative percentages of the Net Investment in Phase I. In Step 2, Minute Driven is distributed to Access and Interoffice in the same proportion as Step 2 Total Depreciation - Access and Interoffice are respectively to Step 1 Total Depreciation - Minute Driven. In Step 3, Minute Driven is distributed to Local Interoffice and Toll in the same proportion as Step 3 Total Depreciation - Local Interoffice and Toll are respectively to Step 2 Total Depreciation - Interoffice.

IDENTIFICATION AND ASSIGNMENT FACTORS

Big Three Factor: This factor is used to distribute depreciation and network expenses proportionally based on the accounts which they support. Those accounts are included in the three major expense categories: plant specific (excluding support accounts); plant non-specific and customer operations. Expenses are distributed based on the level of these "Big Three" expenses. This methodology is a commonly used apportionment method and is described in the FCC's Part 36 Separations procedures.

Customer Interest Factor: Is the interest rate multiplied against the Customer Deposits to determine the Interest Expense that will be avoided.

Hybrid Switching/Trunking Factor: The distribution of Network Operations - Power, Network Administration, Testing, Plant Administration, Engineering and Support between the Access and Interoffice functions uses the weighted sum of the Switching Minute Driven Factor for access and the Trunking Minute Driven Factor for access to determine the distribution to the Access function and the remainder is assigned to the Interoffice function. The weighting is driven by the use of Switching and Trunking Access by the portion of Network CO - Operator Systems, Network CO - Switching, Network CO - Circuit and Cable and Wire that are associated with Switching and Trunking. This hybrid weighting of minutes for both Switching and Trunking provides a reasonable means for distributing the minute driven costs of the administrative activities.

Local Conversation Minutes: A component in many of the Switching factors used throughout the model to assign costs to various Product Lines. Equal to the Local DEM divided by 2.12. This 2.12 factor accounts for the originating and terminating points and allows for breakage (ring no answer, etc.).

Local Dial Equipment Minutes (DEM): Used as an element for the development of Local Conversation Minutes and Local Interoffice Minutes. The Local DEM is created by taking the Intrastate DEM from the 43-04 multiplied by the Local State DEM Factor, defined as Local DEM divided by the Total Intrastate DEM as reported in the NECA Operating Statistics Report. This result is multiplied by a factor for Local Switched Minutes of Use from the 1989 FCC Study.

Local Interoffice Minutes: A component in the Switching and Trunking factors used throughout the model to assign costs to various functional categories. Equal to the Intrastate DEM from ARMIS 43-04 multiplied by the Local State DEM factor minus Local DEM minutes and the result is converted to conversation minutes by dividing by 2.12.

Subscriber Switching Factor: Is 19.9% which is an AT&T estimate of how much switching capacity is dedicated to the subscriber line versus costs associated with the minute driven business.

Switched Access Factor: Used to assign Intrastate Network Access revenues to Switched Access and Private Line revenues. The factor is developed by multiplying the AT&T Intrastate Access rate by the RBOC Intrastate minutes which yields an estimated Total Switched Access Revenues which is then divided by the Total State Access Revenues.

Switching Interoffice Factor: The factor developed when Local Interoffice and Toll Minutes are multiplied by weighting factors of 2.07 for Local Interoffice and 2.4 for Toll. The percentage of weighted results are appropriate for distribution Switching Interoffice expenses (i.e. Depreciation - Switching and Network CO - Switching) between the Local Interoffice and Toll functions. The weighting factors are developed by taking the number of switches used on the various type of calls weighted by the percentage of calls of that type made. Minutes are a reasonable means for distributing the costs of the switching activity.

Switching Minute Driven Factor: The factor developed when Local, Access, Local Interoffice and Toll Minutes are multiplied by weighting factors of 1 for Local, 1.4 for Access, 2.07 for Local Interoffice and 2.4 for Toll. The percentage of weighted results are appropriate for distributing Switching Minute Driven expenses (i.e. Depreciation - Switching and Network CO - Switching) between the Subscriber Line, Access and Interoffice functions. The weighting factors are developed by taking the number of switches used on the various type of calls weighted by the percentage of calls of that type made. Minutes are a reasonable means for distributing the costs of the switching activity.

Toll Minutes: Toll minutes are calculated using two methodologies. The method that yields the most reasonable answer is chosen. Reasonableness is characterized as being within a range of acceptable revenues per toll minute. Method I calculates Toll Minutes by subtracting Intrastate InterLATA minutes from Non-local Intrastate minutes. Method II calculates an average Minute per Call for Intrastate IntraLATA traffic and multiplies this average against Total IntraLATA Intrastate Calls to arrive at Toll Minutes.

Trunking Interoffice Factor: The factor developed when Local Interoffice and Toll Minutes are multiplied by weighting factors of 1.07 for Local Interoffice and 1.4 for Toll. The percentage of weighted results are appropriate for distributing Trunking Interoffice expenses (i.e. Depreciation - General Support, Depreciation - Cable & Wire, Network CO - Circuit, Network Cable & Wire, Operations - Power, Operations - Network Administration, Operations - Testing, Operations - Plant Administration, Operations - Engineering and Network Support) between the Local Interoffice and Toll functions. The weighting factors are developed by taking the number of trunks used on the various types of calls weighted by the percentage of calls of that type made. Trunking minutes are a reasonable means for distributing minute driven costs of the trunking activity.

Trunking Minute Driven Factor: The factor developed when Access, Local Interoffice and Toll Minutes are multiplied by weighting factors of 1.4 for Access, 1.07 for Local Interoffice and 1.4 for Toll. The percentage of weighted results are appropriate for distributing Trunking Minute Driven expenses (i.e. Depreciation General Support, Depreciation - Cable & Wire, Network CO - Circuit, and Network Cable & Wire) between the Access and Interoffice functions. The weighting factors are developed by taking the number of trunks used on the various types of calls weighted by the percentage of calls of that type made. Trunking minutes are a reasonable means for distributing minute driven costs of the trunking activity.

Uncollectible Factor: Represents the rate of uncollectibles as a percent of revenue AT&T experiences in the long distance marketplace.

**1995 FLORIDA
GTE AVOIDED RETAIL COSTS
LOCAL BUSINESS
(\$000's)**

FPSC EXHIBIT NUMBER _____
FPSC DOCKET 960847-TP
LERMA EXHIBIT AL-4
GTE AVOIDED RETAIL COSTS
PAGE 1 OF 1

<u>Cost Category/Part 32 Account</u>	Local A	Avoided Retail Cost Factor B	Avoided Retail Amount C (Col A*Col B)
1 Uncollectibles - (5301)	24,746	100.0%	24,746
2 Product Management - (6611)	4,182	100.0%	4,182
3 Sales - (6612)	11,629	100.0%	11,629
4 Product Advertising - (6613)	7,931	100.0%	7,931
5 Customer Service & Billing - (6623)	42,941	100.0%	42,941
6 Operations - Testing (6533)	19,278	20.0%	3,856
7 Operations - Plant Administration (6534)	15,767	20.0%	3,153
8 Call Completion - (6621)	6,145	100.0%	6,145
9 Directory Assistance - (6622)	3,415	100.0%	3,415
10 Depreciation - Operator Systems - (ARMIS 43-04 Line	4,535	100.0%	4,535
11 Network - Co-Operator Systems - (6220)	1,704	100.0%	1,704
12 DIRECTLY AVOIDED COSTS (Lines 1 thru 11)	142,273		114,237
13 Network Support - (6120 & 6110)	71,481	23.7%	16,917
14 Depreciation Support - (ARMIS 43-04 Line 6020)	26,282	23.7%	6,220
15 General & Administrative - (6710, 6721, 6722, 6723, 6724, 6725, 6726, 6727, 6728, 7240)	156,048	23.7%	36,932
16 Net Other Interest / Customer Deposits (7540)	4,562	03.5%	159
17 Return	182,185	02.6%	4,776
18 Income Taxes	61,969	02.6%	1,624
19 INDIRECTLY AVOIDED COSTS (Lines 13 thru 18)	502,527		66,629
20 TOTAL AVOIDED COSTS (Lines 12 and 19)			180,866
21 REVENUES	584,445		
22 DISCOUNT			30.9%

Calculations

Indirect Factor = Avoided Direct Costs / (Total Costs - Total Indirect Costs)
= \$114,237 / (\$985,210 - \$502,527)

Net Other Interest = 100% of Interest on Customer Deposits portion of the account

Return & Income Taxes = (General Support Facilities Investment / Total TPIS) * (Indirect Factor)

Total Costs = Total Local BU + Return + Taxes + Net Other Interest
= \$736,494 + \$182,185 + \$61,969 + \$4,562

Gen'l Support Facilities	\$322,501
Total Tele Plant in Service	\$2,911,776
% Gen'l Supp/Total TPIS	11.1%

1995 REGULATED GTE Florida Incorporated - FLORIDA Financials

Baseline version as a percent of revenues

Total Local Business

(\$ 000's)

	Total Local BU	Avoided Retail Cost Factor	Avoided Retail Amount	Footnotes to computations	Total Local \$per Ln/12	Avoided Retail \$per Ln/12
Revenues	\$584,445	30.9%	\$180,867	discount is 30.9 % of revenue	\$24.75	\$7.66
Interconnection	\$0					
Uncollectibles	\$24,746	100.0%	\$24,746	no uncollectibles with AT&T	\$1.05	\$1.05
Depreciation	\$235,119		\$10,755		\$9.96	\$0.46
Equal Access	\$0				\$0.00	\$0.00
Gen Support	\$26,282	23.7%	\$6,220	directs / total - indirects	\$1.11	\$0.26
Switching	\$46,751				\$1.98	\$0.00
Oper Syst	\$4,535	100.0%	\$4,535	AT&T will use its own Ops.	\$0.19	\$0.19
Circuit	\$38,754				\$1.64	\$0.00
IOT	\$7,200				\$0.30	\$0.00
C&W	\$111,598				\$4.73	\$0.00
Other	\$0				\$0.00	\$0.00
Network	\$253,898		\$35,191		\$10.75	\$1.49
Support	\$71,481	23.7%	\$16,918	directs / total - indirects	\$3.03	\$0.72
CO - Operator Systems	\$1,704	100.0%	\$1,704	AT&T will use its own Ops.	\$0.07	\$0.07
CO - Switching	\$36,753				\$1.56	\$0.00
CO - Circuit	\$3,061				\$0.13	\$0.00
Info O/T	\$10,215				\$0.43	\$0.00
Cable & Wire	\$58,333				\$2.47	\$0.00
Oper - Power	\$4,909				\$0.21	\$0.00
Oper - Ntwk Admin	\$14,239				\$0.60	\$0.00
Oper - Testing	\$19,278	20.0%	\$3,856	have our own cust. interface	\$0.82	\$0.16
Oper - Plant Admin	\$15,767	20.0%	\$3,153	have our own cust. interface	\$0.67	\$0.13
Oper - Eng	\$6,809				\$0.29	\$0.00
Equal Access	\$16				\$0.00	\$0.00
Other	\$1,774				\$0.08	\$0.00
Call Completion	\$6,145	100.0%	\$6,145	AT&T will use its own Ops.	\$0.26	\$0.26
DA	\$3,415	100.0%	\$3,415	AT&T will use its own Ops.	\$0.14	\$0.14
Pub Dir	\$0				\$0.00	\$0.00
Marketing, Sales & Adv	\$51,024	100.0%	\$51,024	no retail exp with wholesale	\$2.16	\$2.16
Product Management	\$4,182	100.0%	\$4,182	operation	\$0.18	\$0.18
Sales	\$11,629	100.0%	\$11,629		\$0.49	\$0.49
Advertising	\$7,931	100.0%	\$7,931		\$0.34	\$0.34
Order Proc - IXC	\$0	100.0%	\$0		\$0.00	\$0.00
Order Proc - EU	\$16,411	100.0%	\$16,411		\$0.69	\$0.69
Other Cust. Operations	\$10,870	100.0%	\$10,870		\$0.46	\$0.46

1995 REGULATED GTE Florida Incorporated - FLORIDA Financials
Baseline version as a percent of revenues
Total Local Business
(\$ 000's)

	Total Local BU	Avoided Retail Cost Factor	Avoided Retail Amount	Footnotes to computations	Total Local \$per Ln/12	Avoided Retail \$per Ln/12
Billing	\$15,660	100.0%	\$15,660	no retail exp with wholesale operation	\$0.66	\$0.66
IXC - Msg Proc	\$0		\$0		\$0.00	\$0.00
IXC - Postage	\$0		\$0		\$0.00	\$0.00
IXC - Inq.	\$0		\$0		\$0.00	\$0.00
IXC - Collection	\$0		\$0		\$0.00	\$0.00
CABS	\$0		\$0		\$0.00	\$0.00
EU - Msg Proc	\$0	100.0%	\$0		\$0.00	\$0.00
EU - Postage	\$5,659	100.0%	\$5,659		\$0.24	\$0.24
EU - Inq.	\$4,077	100.0%	\$4,077		\$0.17	\$0.17
EU - Collection	\$5,923	100.0%	\$5,923		\$0.25	\$0.25
Coin Collect	\$0		\$0	\$0.00	\$0.00	
G&A	\$156,048	23.7%	\$36,932	directs / total - indirects	\$6.61	\$1.56
Executive	\$5,397	23.7%	\$1,277		\$0.23	\$0.05
Finance	\$9,598	23.7%	\$2,272		\$0.41	\$0.10
Regulatory	\$5,666	23.7%	\$1,341		\$0.24	\$0.06
IMS	\$42,907	23.7%	\$10,155		\$1.82	\$0.43
Legal	\$1,442	23.7%	\$341		\$0.06	\$0.01
R & D	\$3,047	23.7%	\$721		\$0.13	\$0.03
Human Resources	\$7,599	23.7%	\$1,799		\$0.32	\$0.08
Procurement	\$1,150	23.7%	\$272		\$0.05	\$0.01
Other	\$32,546	23.7%	\$7,703		\$1.38	\$0.33
Tax	\$46,695	23.7%	\$11,051	\$1.98	\$0.47	
Totals	\$736,494		\$174,308		\$31.19	\$7.38
Net operating Revenues	(\$152,049)					
Net Investment	\$1,619,424					
Return @ 11.25%	\$182,185	2.6%	\$4,776		\$7.72	\$0.20
FIT Gross Up @ 35%	\$61,969	2.6%	\$1,624		\$2.62	\$0.07
State & Lcl Income Tax	\$0	2.6%	\$0		\$0.00	\$0.00
Net Other Interest	\$4,562	3.5%	\$159	Interest on Customer Deposits	\$0.19	\$0.01
Total Discount		30.9%	\$180,867		\$41.72	\$7.66
Gross Investment						
Gen'l Support Facilities	\$322,501					
Total Tele Plant in Servic	\$2,911,776					
% Gen'l Supp/Total TPIS	11.1%					

THE AT&T AVOIDED RETAIL COST MODEL

CALCULATIONS/ASSUMPTIONS

After the Avoided Retail Cost model creates the final LEC Income Statement by product line, we are able to go through the individual expense lines and determine which expenses would be "avoided" by the LEC in a wholesale business.

REVENUE/EXPENSE	PERCENT AVOIDED	REASONS
Revenues	%	The factor shown here is equal to the total avoided costs divided by the revenues. It is shown here to show the impact of the discount on revenue.
Uncollectibles	100%	The LEC will have no uncollectibles with AT&T
Depreciation		
General Support	Variable *	This indirect expense will follow the direct expenses; Uncollectibles, Depreciation - Operator Systems, Network - CO Operator Systems, Call Completion, Directory Assist., Marketing, Sales, Advertising and Billing
Operator Systems	100%	AT&T will use its own operators
Network		
Support	Variable *	This indirect expense will follow the direct expenses; Uncollectibles, Depreciation - Operator Systems, Network - CO Operator Systems, Call Completion, Directory Assist., Marketing, Sales, Advertising and Billing
CO-Operator Systems	100%	AT&T will use its own operators
Operation - Testing	20%	AT&T will maintain its own customer interface to deal directly with customer inquiries.
Operation - Plant Admin.	20%	AT&T will maintain its own customer interface to deal directly with customer inquiries.
Call Completion	100%	AT&T will use its own operators
Directory Assistance	100%	AT&T will use its own operators

EXPENSE	PERCENT AVOIDED	REASONS
Marketing, Sales & Advertising		
Product Management	100%	These retail expenses are not associated with wholesale operations.
Sales	100%	
Advertising	100%	
Order Proc. - IXC	100%	
Order Proc. - EU	100%	
Other Cust. Operations	100%	
Billing		
End User		AT&T will do its own billing.
Message Processing	100%	
Postage	100%	
Inquiry	100%	
Collection	100%	
General and Administrative		
Executive	Variable *	This indirect expense will follow the direct expenses; Uncollectibles, Depreciation - Operator Systems, Network - CO Operator Systems, Call Completion, Directory Assist., Marketing, Sales, Advertising and Billing
Finance	Variable *	
Regulatory	Variable *	
IMS	Variable *	
Legal	Variable *	
R & D	Variable *	
Human Resources	Variable *	
Procurement	Variable *	
Other	Variable *	
Tax	Variable *	
Return	Variable **	Reduced by an amount reflecting retail activity
Income Taxes	Variable **	Reduced by an amount reflecting retail activity
Other Interest Deductions (7540)	Variable ***	Interest on Customer Deposits not required.
		* The factor is calculated by summing the avoided costs for the direct expense categories and dividing that sum by the total local expense less the local indirect expense.
		** This factor is equal to Total General Support Assets divided by Total Plant in Service, multiplied by the avoided percent for indirect expense as identified in the factor above.
		*** The factor is calculated by dividing the amount of interest applicable to customer deposits by the total of net other interest.