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September 6, 1996

Ms. Blanca Bayo, Director
Division of Records and Reporting
Room 110, Easley Building
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, Florida 32399-0850

BY HAND DELIVERY

Re: Docket No. 960916-TP

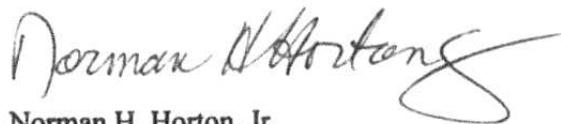
Dear Ms. Bayo:

Enclosed is an original and fifteen copies each of American Communications Services, Inc. and American Communication Services of Jacksonville, Inc.'s Motion for Leave to File Supplemental Testimony and the Testimony of Marvin H. Kahn in the above-referenced docket.

Please indicate receipt of this document by stamping the enclosed extra copy of this letter.

Your attention to this filing is appreciated.

Sincerely,



Norman H. Horton, Jr.

- ACK _____
- AFA _____
- APP _____
- CAF _____
- CMU _____
- CTR _____
- EAG _____
- LEG _____
- LIN _____
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Enclosures

cc: James Falvey
Parties of Record

Testimony
RECEIVED & FILED DOCUMENT NUMBER-DATE
09525 SEP-6 96
FPSC-BUREAU OF RECORDS
FPSC-RECORDS/REPORTING

Motion
DOCUMENT NUMBER-DATE
09524 SEP-6 96
FPSC-RECORDS/REPORTING

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

~~960916-TP~~

SUPPLEMENTAL TESTIMONY

OF

DR. MARVIN H. KAHN

ON BEHALF OF

AMERICAN COMMUNICATIONS SERVICES, INC.

SEPTEMBER 6, 1996

DOCUMENT NUMBER-DATE

~~09525~~ SEP-68

FPSC-RECORDS/REPORTING

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2
3 **SUPPLEMENTAL TESTIMONY OF DR. MARVIN H. KAHN**

4
5 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS**
6 **ADDRESS.**

7 **A. My name is Marvin H. Kahn. I am a Senior Economist and a founding**
8 **principal of Exeter Associates, Inc. Our offices are located at 12510**
9 **Prosperity Drive, Silver Spring, Maryland 20904.**

10 **Q. ARE YOU THE SAME MARVIN H. KAHN WHO SUBMITTED**
11 **TESTIMONY ON BEHALF OF AMERICAN COMMUNICATIONS**
12 **SERVICES, INC. (ACSI) IN THIS PROCEEDING?**

13 **A. Yes, I am.**

14 **Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL**
15 **TESTIMONY?**

16 **A. At the time my original testimony was filed, the FCC had announced the**
17 **release of the First Report and Order¹ (FCC Order) implementing**
18 **Sections 251 and 252 of the Telecommunications Act of 1996 (Act).**
19 **Since then, I have had an opportunity to review the FCC Order and**
20 **assess the impact of the FCC's rulings on the recommendations of my**
21 **testimony. In general, the FCC's rulings fully support my**

22 ¹First Report and Order, Released August 8, 1996, In the Matter of
23 Implementation of the Local Competition Provisions in the Telecommunications
24 Act of 1996, CC Docket No. 96-98.

1 recommendations in terms of the appropriate costing and pricing
2 methodologies to be used for unbundled loop elements. There are (two)
3 areas of my testimony which I believe should be clarified in terms of
4 overall consistency with the FCC Order.

5 The first area relates to the development of rates using the
6 total element long run incremental cost (TELRIC) costing methodology
7 and the FCC position on geographic deaveraging. The second area
8 relates to the FCC's prescribed mark-up over TELRIC and why that
9 ruling is consistent with the recommendations of my testimony. The
10 discussion of each relates the FCC's provisions to my recommendations.

11 TELRIC Costing Methodology

12 Q. PLEASE SUMMARIZE THE FCC'S RULING REGARDING THE
13 COSTING METHODOLOGY FOR PRICING UNBUNDLED LOOPS.

14 A. The FCC adopted specific requirements governing the methodology to
15 be used in developing cost-based rates for interconnection and unbundled
16 elements, including unbundled loops. The general pricing standard
17 requires that rates be established on the basis of a forward-looking
18 economic cost-based pricing methodology. The forward-looking
19 economic cost of an element is defined in the FCC Order as the sum of :

20
21 (1) the total element long-run incremental cost of the element
22 (TELRIC), and
23

1 (2) a reasonable allocation of forward-looking joint and common
2 costs.²

3 TELRIC is the forward-looking cost over the long run of the total
4 quantity of the facilities and functions that are directly attributable to, or
5 reasonably identifiable as incremental to, an element, given the
6 incumbent LEC's provision of other elements. TELRIC and the term
7 total service long run incremental cost (TSLRIC) are identical
8 conceptually. The term TELRIC is used by the FCC in applying the
9 concept to the pricing of network elements.

10 The FCC also required states to establish different rates for
11 unbundled loop elements in at least three defined geographic areas within
12 the state to reflect geographic cost differences.³ In the event that state
13 commissions do not have cost information available which meets the
14 forward-looking economic cost criteria, the FCC produced a statewide
15 average ceiling proxy at or below which unbundled loops can be priced
16 on an interim basis.

17 Q. ARE THE FCC'S RULINGS CONSISTENT WITH YOUR
18 CONCLUSIONS AND RECOMMENDATIONS?

19 A. Yes. I recommended that the appropriate costing methodology for
20 pricing unbundled elements is a TSLRIC approach. As noted above,
21 TSLRIC and the TELRIC approach promulgated by the FCC are

22 ²First Report and Order, Appendix B-Final Rules, §51.505(a).

23 ³*Id.*, §51.507(f).

1 methodologically the same. In addition, the FCC has mandated a
2 minimum of three cost-based density zones. ACSI did not have access
3 to the LEC's cost studies during negotiations. In the absence of LEC
4 sponsored forward-looking economic cost data using the TELRIC (or
5 TSLRIC) approach, I recommended using the best cost information
6 currently available to the extent that information was developed
7 consistent with the TSLRIC/TELRIC methodology. That alternative is
8 the updated Hatfield Model.⁴ This model produces data fully consistent
9 with the TSLRIC/TELRIC principles. The estimates are long run,
10 forward-looking, based on least cost available technology and reflect
11 cost causation. In addition, it provides data by density zone (six density
12 zones) for each state. Therefore, the Hatfield Model meets both the
13 TELRIC methodology requirement and the requirement that costs be
14 deaveraged geographically.

15 Q. YOU MENTIONED THE FCC PROXY CEILING. PLEASE
16 EXPLAIN WHAT THAT NUMBER IS AND HOW THE FCC
17 PROPOSED THAT THE NUMBER BE USED.

18 A. As noted, the FCC required that rates for unbundled elements must be
19 cost based. The FCC established proxy costs for specific network
20 elements to be used in the event that the necessary cost data are not yet
21 available. These proxies take the form of ranges or for some elements,
22 such as the loop, a ceiling. For purposes of determining whether

23 ⁴See Testimony of Marvin H. Kahn, pp. 8-9 and Section V.

1 deaveraged rates for unbundled loop elements comply with the proxy
2 cost ceiling, those actual, geographically deaveraged rates must be less
3 than or equal to the FCC proxy when combined on a weighted average
4 basis.⁵ States may set prices below these ceilings if the record before
5 them supports a lower price.⁶ The default proxies established by the
6 FCC serve merely as presumptive ceilings.

7 States may set rates above the price ceiling only if the state
8 commission has given full and fair effect to cost data based on the
9 methodology prescribed in the FCC Order, i.e., a properly structured
10 TELRIC.

11 Q. HOW DO THE COST ESTIMATES PRODUCED BY THE
12 HATFIELD MODEL COMPARE WITH THE FCC ESTABLISHED
13 PROXIES?

14 A. Yes. The Hatfield Model assigns a portion of joint and common costs to
15 each network element. Even with this, the Hatfield cost estimates are
16 below the FCC estimates. Attachment 1 provides a comparison of the
17 FCC proxy and the current Hatfield estimates on a statewide basis and
18 Hatfield estimates for 6 geographically deaveraged zones.

19 In addition, Attachment 1 displays Hatfield estimates for 3
20 geographically deaveraged density zones. These figures are based on the
21 weighted average of the combined zones. For simplicity, I combined the

22 ⁵First Report and Order, Appendix B-Final Rules, §51.513(b).

23 ⁶First Report and Order, ¶768.

1 two most dense, the two middle, and the two least dense zones in the
2 Hatfield Model. It may be appropriate in particular circumstances to
3 combine zones differently.

4 Q. IS THE MANNER IN WHICH THE HATFIELD MODEL
5 DEAVERAGES LOOP COST INFORMATION BEING UPDATED?

6 A. Yes. The current release of the Hatfield Model defines density zones
7 based upon households per square mile. However, the Hatfield Model is
8 expected to be rereleased shortly with zones defined by loop density. I
9 will be providing the revised Hatfield results to the commission as an
10 update to my testimony once they are available. The changes will not
11 affect the validity of the approach I recommend here, and will merely
12 reflect a refinement in the presentation.

13 Q. HAVE LECS PROVIDED COST INFORMATION ON A
14 GEOGRAPHICALLY DEAVERAGED BASIS?

15 A. No. ILECs are generally incorporating geographic deaveraging into
16 their unbundled loop cost elements only now, in response to the FCC
17 directive. In the event that the ILEC provides cost information that it
18 proposes the Commission rely on in establishing deaveraged rates, ACSI
19 reserves the opportunity to review and respond to such information and
20 supplement testimony, as appropriate.

21 Reasonable Allocation of Joint and Common Costs

22 Q. YOU ALSO MENTIONED THAT THE FCC RULES INCLUDE A
23 MARK-UP FOR JOINT AND COMMON COSTS IN THE

1 DETERMINATION OF FORWARD-LOOKING ECONOMIC COSTS.
2 WHAT CRITERIA HAS THE FCC ESTABLISHED FOR
3 DETERMINING THAT MARK-UP?

4 A. The FCC set two general criteria for the mark-up over TELRIC. First,
5 it required a mark-up to allow for the recovery of forward-looking joint
6 and common costs. At the same time, the FCC required that the mark-
7 up be consistent with the behavior in competitive markets (cite) and be
8 limited to a "reasonable allocation" of "forward-looking" costs.⁷

9 Forward-looking common costs are defined as economic costs efficiently
10 incurred in providing a group of elements or services (which may
11 include all elements or services offered by the LEC) that cannot be
12 attributed directly to an individual element or service.⁸ In determining
13 what is a "reasonable" allocation the FCC imposes two criteria on the
14 allocation of common costs.

- 15 (1) The sum of TELRIC plus the "reasonable" allocation of
16 common cost cannot exceed the stand-alone cost of
17 producing the element, and
18 (2) The sum of the allocations for all elements and services
19 (excluding retail costs) must equal the total forward-
20 looking common costs attributable to operating the
21 incumbent LEC's total network.

22 ⁷First Report and Order, ¶698.

23 ⁸*Id.*, Appendix B - Final Rules, §51.505(c)

1 One reasonable allocation method mentioned in the order is to
2 allocate common costs using a fixed allocator, such as a certain
3 percentage mark-up over the directly attributable forward-looking costs.
4 Another reasonable allocation method proposed by the FCC would be to
5 allocate only a relatively small share of common costs to certain critical
6 network elements, such as the local loop and collocation, since these are
7 facilities that are the most difficult for competitors to duplicate,⁹ i.e.,
8 those facing the greatest barriers to entry. An allocation of common
9 costs on that basis ensures that the price of network elements that are
10 subject to the least competition are not "artificially inflated by a large
11 allocation of common costs."¹⁰

12 Q. WHAT IS YOUR RECOMMENDATION FOR ESTABLISHING THIS
13 MARK-UP OVER TELRIC?

14 A. In my testimony, I proposed that the Commission establish a mark-up
15 for unbundled local loops that is no greater than the mark-up which the
16 ILEC realizes on its competitive network services.

17 Q. IS YOUR PROPOSAL FOR A MARK-UP IN THE PRICING OF
18 UNBUNDLED LOOPS CONSISTENT WITH THE FCC'S RULINGS
19 IN CC DOCKET NO. 96-98?

20 ⁹*Id.* ¶696. The FCC refers to facilities such as the loop as bottleneck
21 facilities in this paragraph.

22 ¹⁰*Id.*

1 A. Yes. In my testimony, I indicated that a mark-up over TSLRIC was
2 appropriate. For the reasons given in my testimony, the FCC required a
3 mark-up over incremental common costs. Second, the FCC limited the
4 mark-up to a 'reasonable level'. The mark-up proposed in my
5 testimony, which would be limited to the mark-up accepted by the ILEC
6 on its most competitive services, is consistent with the FCC mandated
7 limits. A mark-up limit (defined as) the voluntarily accepted return on
8 a competitive service is consistent with the criteria which limits the
9 allocation of common costs to that which could be earned on a stand
10 alone basis and restricts the total or "sum of the allocation" for all
11 elements to the total of forward-looking common costs less retail costs.

12
13 Q. HAS ACSI SOUGHT THE INFORMATION BY WHICH A
14 COMPETITIVE MARKET MARK-UP CAN BE DETERMINED?

15 A. Yes. Data on BellSouth's competitive contracts are being sought in data
16 requests.

17 Q. IF THE INFORMATION TO DETERMINE COMPETITIVE MARK-
18 UPS IS NOT AVAILABLE, WHAT ALTERNATIVES ARE
19 AVAILABLE TO THE COMMISSION?

20 A. The Commission may choose to rely on information from other
21 jurisdictions, such as Pennsylvania and California, where mark-ups of

1 approximately 15 percent have been identified.¹¹ Alternatively, the
2 Commission may select the Hatfield Model cost estimate, which includes
3 an allocation of common cost.

4 Q. DOES THIS COMPLETE YOUR SUPPLEMENTAL TESTIMONY?

5 A. Yes. It does.

6 ¹¹See R.93-04-003, I.93-04-002, Rebuttal Testimony of Dr. Marvin H. Kahn
7 (Revised), July 25, 1996, Tables III and IV and Opinion and Order, Short
8 Form, Application of MFS Intelenet of Pennsylvania, Inc., Docket No. A-
9 310203F0002, Application of TCG Pittsburg, Docket No. A-310213F0002;
10 Application of MCI Metro Access Transmission Services, Inc., Docket No. A-
11 310236F0002; and; and Application of Eastern Telelogic Corp. Docket No. A-
12 320258F0002, page 13.

**Hatfield Default Proxies
by Density Zone including Statewide Average
Florida**

<u>Density Zone (households/sq. mi.)</u>	<u>Six Density Zone Results Loop Cost/Month (\$)</u>
0-5	53.31
5-200	18.95
200-650	13.53
650-850	11.89
850-2550	10.79
> 2550	9.11

	<u>Three Density Zone Results Loop Cost/Month (\$)</u>
0-200	20.06
200-850	12.94
> 850	10.12

	<u>Statewide Average Loop Cost/Month (\$)</u>
Hatfield Statewide Weighted Average	11.37
FCC Proxy Ceiling	13.68

Sources:

- (1) Hatfield Model Version 2.2, Release 1, submitted by AT&T on July 3, 1996, as an Ex Parte Presentation to the FCC in CC Docket No. 96-98.
- (2) First Report and Order, Released August 8, 1996, In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, Appendix D, "State Proxy Ceilings for the Local Loop."