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September 20, 1996

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

Re: Docket No. 960847-TP  
Petition by AT&T Communications of the Southern States, Inc. for  
arbitration of certain terms and conditions of a proposed agreement  
with GTE Florida Incorporated concerning interconnection and resale  
under the Telecommunications Act of 1996

Re: Docket No. 960980-TP  
Petition by MCI Telecommunications Corporation and MCI Metro Access  
Transmission Services, Inc. for arbitration of certain terms and conditions  
of a proposed agreement with GTE Florida Incorporated concerning  
interconnection and resale under the Telecommunications Act of 1996

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Dear Ms. Bayo:

Please find enclosed for filing in the above matter an original and fifteen copies of GTE Florida Incorporated's Motion to Deny AT&T's Request Regarding Implementation of the FCC's Default Proxy Rates and Brief in support thereof. Also enclosed is a diskette with a copy of the Brief in WordPerfect 5.1 format.

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Ms. Blanca S. Bayo  
September 20, 1996  
Page 2

Service has been made as indicated on the Certificate of Service. If there are any questions regarding this matter, please contact me at (813) 228-3087.

Very truly yours,

  
Anthony P. Gillman

APG:tas  
Enclosures

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**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

In re: Petition by AT&T Communications ) of the Southern States, Inc. for arbitration ) of certain terms and conditions of a proposed ) agreement with GTE Florida Incorporated ) concerning interconnection and resale under ) the Telecommunications Act of 1996 ) _____ ) )	Docket No. 960847-TP Filed: September 20, 1996
In re: Petition by MCI Telecommunications ) Corporation and MCI Metro Access ) Transmission Services, Inc. for arbitration of ) certain terms and conditions of a proposed ) agreement with GTE Florida Incorporated ) concerning interconnection and resale under ) the Telecommunications Act of 1996 ) _____ ) )	Docket No. 960980-TP

**GTE'S MOTION TO DISMISS REQUEST OF AT&T AND MCI TO ESTABLISH  
THE FCC'S DEFAULT PROXY RATES AND TO STRIKE TESTIMONY**

GTE Florida Incorporated ("GTE"), moves the Florida Public Service Commission to dismiss AT&T's and MCI's requests that the non-compensatory default proxy rates established by the Federal Communications Commission (FCC) be considered in this proceeding. Imposition of these rates would impose enormous, irreparable and unconstitutional losses on GTE. Rather, any prices established by the Commission must be determined only after a full hearing wherein GTE will be entitled to present evidence on Florida-specific pricing and cost related issues as required by Section 252 of the Telecommunications Act of 1996 ("the Act").

As discussed more fully in the accompanying brief, the FCC's default proxy rates must be rejected in this proceeding for the following reasons: (1) as recognized by the Commission, the proxy rates were unlawfully promulgated by the FCC because the FCC

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does not have the jurisdiction or authority to preempt States on intrastate costing and pricing issues and to require them to use default proxy rates; (2) the default and proxy rates are constitutionally and statutorily defective because they do not reflect any of GTE's joint and common costs or all of GTE's incremental costs; (3) this Commission would be committing an unconstitutional taking of GTE's property by imposing the proposed default proxy rates;<sup>1</sup> and (4) this Commission has moved, or will so move in the near future, for a stay of FCC's First Report and Order, and any consideration of the proxy rates would undermine that motion.

At the internal affairs meeting held on September 16, 1996, counsel for both AT&T and MCI urged the Commission to consider the proxy rates as an alternative to considering the cost studies submitted by GTE in this case. It is clear that this is a blatant attempt by these parties to seize GTE's assets at below cost prices. These parties presumably will continue to advocate implementation of the proxy rates despite the fact that the Florida Commission will be seeking a stay of the FCC's Order. At that meeting, the question was raised whether the Commission could impose the FCC's proxy rates. Although any pricing decision over these rates belongs to the Commission, there is no evidentiary support (indeed, no support whatsoever except for the FCC Order) justifying imposition of such proxy rates, even on an interim basis. As reflected in the affidavit of Dennis Trimble, the

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<sup>1</sup> It should be specially noted that allowing AT&T to succeed by implementing the default proxy prices may well leave this Commission responsible for the unconstitutional taking of GTE's property. This point also is addressed in the attached brief.

proxy rates cannot, as a matter of law, meet the statutory requirements of the Section 252 and if implemented will constitute an unconstitutional taking of GTE's property.

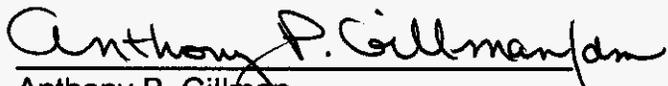
Specifically, GTE seeks the following relief in this motion:

1. Dismiss Paragraph 26(c) of AT&T's Petition asking that the Commission "[p]rice on an interim basis at any appropriate FCC default price all unbundled network elements identified on Exhibit MG-2 to Mr. Guedel's testimony."
2. Dismiss Paragraph 27 of the AT&T Petition requesting the Commission to "[p]rice call termination at \$.002 per interconnection minute of use."
3. Dismiss Paragraph 29(b) of AT&T's Petition requesting the Commission to price items relating to access to rights-of-way, poles, conduits and ducts, collocation number portability, AIN and unused transmission media "in the interim at any appropriate FCC default price."
4. Strike the testimony of Mike Guedell requesting the Commission to implement FCC default prices on an interim basis (Guedell Direct Test., lines 16-17).
5. Dismiss MCI's petition that seeks implementation of the proxy rates pending the establishment of rates based upon cost studies (MCI Petition at 14-15; 28, 33-34); and
6. Strike the testimony of Sarah Goodfriend (p. 20, lines 14-25) and Don Price (p. 22, lines 22-25) discussing the establishment of rates based upon the FCC's proxies.

For all the reasons set forth in the accompanying brief, GTE requests that this Commission dismiss the request of AT&T and MCI for implementation of the proxy rates and to strike the references noted above and all other references in the testimony requesting that such rates should be implemented either on a permanent or interim basis.

Alternatively, if this Commission decides it cannot evaluate the cost and price-related materials presented in this arbitration within the timeframe established by the Act, then GTE respectfully requests that the Commission adopt GTE's proposed rates on an interim basis subject to refund. This proposal is consistent with traditional rate-making practice, and better balances the interests of all the parties.

Respectfully submitted on September 20, 1996.

By:   
Anthony P. Gillman  
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Post Office Box 110, FLTC0007  
Tampa, Florida 33601  
Telephone: 813-228-3087

Attorneys for GTE Florida Incorporated

**BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

In re: Petition by AT&T Communications )  
of the Southern States, Inc. for arbitration )  
of certain terms and conditions of a proposed )  
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\_\_\_\_\_ )

Docket No. 960847-TP  
Filed: September 20, 1996

In re: Petition by MCI Telecommunications )  
Corporation and MCI Metro Access )  
Transmission Services, Inc. for arbitration of )  
certain terms and conditions of a proposed )  
agreement with GTE Florida Incorporated )  
concerning interconnection and resale under )  
the Telecommunications Act of 1996 )  
\_\_\_\_\_ )

Docket No. 960980-TP

**GTE'S BRIEF IN SUPPORT OF ITS MOTION TO DISMISS  
AT&T'S AND MCI'S REQUEST REGARDING IMPLEMENTATION  
OF THE FCC'S DEFAULT PROXY RATES  
AND MOTION TO STRIKE**

**I. PRELIMINARY STATEMENT**

At its internal affairs meeting held on September 16, 1996, the Commission authorized its General Counsel to seek a stay of the FCC's Final Report and Order No. 96-98 ("Interconnection Order"). In doing so, the Commission expressed its intent not to be bound by that Order; rather the Commission has made it clear that it intends to make its own interpretation of the Telecommunications Act of 1996 ("Act") in addressing the petitions for arbitration filed by AT&T and MCI. At the meeting, counsel for AT&T and MCI both recommended that the Commission should implement the proxy rates set forth by the FCC in the Interconnection Order. Although this Commission unquestionably has the authority to make pricing decisions pursuant to Section 252 of the Act, GTE contends that

there is no basis for imposing the FCC's proxy rates in this case. In fact, if this Commission establishes those proxy rates on GTE, this Commission will be imposing enormous, irreparable and unconstitutional losses on GTE. There can be no basis for such action. The Fifth Amendment of the Constitution of the United States requires that GTE be compensated fully for any property that is taken from it. Requiring GTE to deliver its property to companies such as AT&T, the world's fifth largest company, at below cost prices is unconscionable and unconstitutional. Nothing in the Telecommunications Act of 1996 requires or authorizes such an act. Indeed, the Act expressly declares that local exchange carriers such as GTE are entitled to receive a reasonable profit above and beyond its costs. The losses will be irreparable as AT&T and MCI take GTE's subsidized services and elements to eviscerate GTE's share of the local telephone market. It will be very hard for GTE to regain these customers even if rates are properly reset. In short, there is no effective mechanism by which GTE can be made whole for the losses sustained.

Lest there be any doubt, this Commission should understand that notwithstanding that although it was an Act of Congress that opened up the telecommunications industry to full competition, it may well be this Commission that will be taking unconstitutionally GTE's property by imposition of default proxy rates. Such an action cannot be justified by reference to the FCC's Order whose terms (which are still not even legally effective) are directly contrary to the express terms of the Telecommunications Act. As such, they are unlawful as well as unconstitutional.

This Commission should not even consider allowing AT&T and MCI to succeed in its pre-dawn raid for GTE's assets at below cost prices. Rather, any pricing decision should be made upon GTE's testimony regarding the true costs of its services and elements under Section 252 of the Act. AT&T's and MCI's motivation is transparent: They know that the FCC's default proxy rates will result in a huge windfall for them. This is because the default proxy rates do not even begin to approach the level of just compensation that AT&T and MCI are required to pay under the Act, the state and federal constitutions, or even the FCC's own rules and pronouncements.

In sum, this Commission must not adopt the FCC's proposed default proxy rates because (1) as recognized by the Commission, they were unlawfully promulgated by the FCC because the FCC does not have the jurisdiction or authority to preempt States on intrastate costing and pricing issues and to require them to use default proxy rates; (2) the default and proxy rates are constitutionally and statutorily defective because they do not reflect any of GTE's joint and common costs or all of GTE's incremental costs; (3) it is this Commission that would be committing the unconstitutional taking by imposing the proposed default proxy rates; and (4) none of the provisions of the Interconnection Order are yet effective and the Commission has sought a stay of that Order.

## **II. BACKGROUND**

AT&T and MCI filed their applications for arbitration pursuant to section 252 of the Act. The Act generally requires incumbent local exchange carriers ("LECs"), such as GTE, to provide interconnection and access to unbundled network elements at rates determined

by State commissions to be "just and reasonable." Act, §§ 251(c)(2) and 251(c)(3). The Act further provides that rates for interconnection and unbundled elements shall be "based on cost" and "may include a reasonable profit." Act, § 252(d)(1). The Act further requires LECs to offer for resale at wholesale rates any services provided by the LEC at retail. Act, § 251(c)(4). State commissions, in the context of arbitrations, are directed to determine wholesale rates "on the basis of retail rates . . . excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier." Act, § 252(d)(3).

On August 8, 1996, the FCC released its Interconnection Order. One of the most legally erroneous portions of the Interconnection Order is its discussion of pricing for interconnection, unbundled elements, and resale. See generally Interconnection Order, ¶¶ 767-836. The Interconnection Order "strongly encourage[s] state commissions, as a general rule, to set arbitrated rates for interconnection and access to unbundled network elements pursuant to the forward-looking, economic cost pricing methodology we adopt in this Order." Id., ¶ 767. The FCC notes that, "in some cases, it may not be possible for carriers to prepare, or the state commission to review, economic cost studies within the statutory time frame for arbitration." Id. In such cases, the Interconnection Order purports to direct state commissions to adopt certain default proxy rates for interconnection and unbundled elements until such time as the state commission adopts forward-looking costs using a TELRIC methodology. Id.

The FCC also purports to establish a methodology for calculation of avoided costs, for purposes of determining resale rates. Id., ¶¶ 911-920. The FCC also announces a

default range of discount rates from 17 to 25 percent below retail rates as a proxy for the LECs' avoided costs. *Id.*, ¶ 932. The FCC asserts that state commissions must apply discounts within that range until the state has reviewed and approved an avoided cost study that complies with the FCC's prescribed methodology. *Id.*, ¶ 910.

The FCC's Interconnection Order becomes effective 30 days after a summary is published in the Federal Register, unless it is stayed by the FCC or a court. 47 C.F.R. § 1.427. The Federal Register summary was published on August 29, and the Order therefore is scheduled to become effective on September 30. Numerous parties, however, including GTE and the National Association of Regulatory Utility Commissioners ("NARUC") and individual state commissions, have filed petitions for review of the FCC's Order.<sup>1</sup> In addition, GTE and others have filed motions for stay at the FCC on August 28, and, GTE has filed a motion for stay with the 8th Circuit. Many of these parties, including NARUC, have challenged the FCC's legal authority to promulgate default proxy rates and its authority under section 2(b) of the Act to preempt States' authority to set rates regarding intrastate service. Moreover, the Florida Commission will also be filing a stay before the FCC and it is GTE's understanding that such a stay will also be filed with the 8th Circuit.

### **III. ARGUMENT**

#### **A. THE DEFAULT PROXY RATES ARE AN UNLAWFUL ACT OF THE FCC.**

The Commission should not apply the FCC's default proxy rates because the FCC acted unlawfully in promulgating those rates. The states need not and should not fail to

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<sup>1</sup> Petitions have been filed by Pacific Telesis, US West, Bell Atlantic, Bell South, Cincinnati Bell, NARUC, and the New York and Iowa Public Service Commissions.

exercise their authority in the presence of FCC action that is plainly beyond the FCC's power. Indeed, this was recognized by the Commission in authorizing its General Counsel to file a motion for a stay before the FCC and the Courts. The FCC's attempt to set national pricing terms for agreements under §§ 251 and 252 of the Act is nothing short of a brazen effort to grab power from state commissions by usurping the role explicitly assigned to them under the Act. It could not be clearer -- both under the Act and under section 2(b) of the Communications Act of 1934 -- that the FCC lacks the power to promulgate rules governing intrastate pricing.<sup>2</sup>

Congress' decision to give authority over pricing exclusively to state commissions was purposeful. The role assigned to state agencies is inextricably linked with the procedures Congress devised in Section 252 for ensuring that arbitrated agreements

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<sup>2</sup> The Act expressly assigns state commissions, not the FCC, the power to determine prices through the arbitration process. In terms that could not be clearer, § 252(c)(2) provides that "a State Commission shall . . . establish any rates for interconnection, services, or network elements according to subsection (d)." 47 U.S.C. § 252(c)(2) (emphasis added). Section 252(d)(1) then goes on to provide that "[d]eterminations by a State commission of the just and reasonable rate for interconnection . . . shall be based on . . . cost" and "may include a reasonable profit." 47 U.S.C. § 252(d)(1) (emphasis added). Similarly, § 252(d)(3), governing resale of services, expressly provides that "a State commission shall determine wholesale rates." 47 U.S.C. § 252(d)(3) (emphasis added). These sections assign to the State commissions -- not the FCC -- the power to set prices for interconnection, unbundling, and resale in arbitrations. By contrast, Congress expressly omitted any reference to FCC regulations with respect to setting prices. Further, Section 2(b) provides that "nothing in this Act shall be construed to apply or to give the [FCC] jurisdiction with respect to . . . charges, classifications, practices, services, facilities, or regulations for or in connection with intrastate communications service." 47 U.S.C. § 152(b) (1994). The Supreme Court has held that this "congressional denial of power to the FCC" over prices and other matters regarding the provision of local telephone service can be overcome only if Congress includes "unambiguous" and "straightforward" language in the Act either modifying §2(b) or expressly granting the FCC additional authority. See Louisiana Public Service Comm'n, 476 U.S. at 375, 377 (1986).

would conform to the terms of the Act. By design, arbitrations were to be evidentiary proceedings involving fact-specific, essentially adjudicative decision making tied to the circumstances of individual cases. They thus require local supervision by individual state commissions.

Any attempts by AT&T and MCI to have this Commission impose the FCC's proxy rates should be curtailed now because any consideration of those proxy rates undermines the procedures Congress outlined for determining prices under the Act. Under the Act, state-supervised arbitrations were the mechanism for ensuring compliance with the terms of the statute where parties could not reach privately negotiated agreements. Arbitrations are to involve adjudicative proceedings in which parties will be able to present evidence and obtain an individualized judgment from a state commission based on the circumstances of a particular case, rather than through a rulemaking (an abbreviated rulemaking at that ) as done by the FCC. Such an evidentiary proceeding is particularly critical for pricing determinations to ensure that prices reflect the specific factual situation faced by each carrier. Only with such case-specific consideration could the statutory command that prices be "based on cost" be properly implemented. See § 252(d).

GTE moves to dismiss the request for AT&T and MCI for imposition of the proxy rates because in imposing those rates, the Commission would improperly eliminate the case-specific decision making that Congress devised for pricing determinations under the Act. Cf. Natural Resources Defense Council, Inc. v. Herrington, 768 F.2d 1355, 1396 (D.C. Cir. 1985) ("[A]n agency may not ignore the decision making procedure Congress specifically mandated because the agency thinks it can design a better procedure."). But

the impact of the FCC's actions in undermining the process devised by Congress does not end there. Rather, the very rules the FCC has set will preclude state arbitrations from ever fully providing the case-specific decision making envisioned under the Act. Thus, by determining, for example, that state commissions must be prohibited from even considering historical costs in determining prices, the FCC has skewed the process of state arbitrations from the start and preempted full consideration of all the circumstances of individual cases by state commissions.

**B. THE FCC'S DEFAULT PROXY RATES GROSSLY UNDERESTIMATE GTE'S ACTUAL COSTS.**

The Commission should dismiss any request for imposition of the default rates promulgated in the Interconnection Order because those rates are not supported by any competent and substantial evidence and grossly underestimate GTE's actual costs. After outlining a detailed method for measuring costs, the FCC proceeded to set prices based on studies that used different methods or that measured costs for only a fraction of the network element being priced as the following discussion shows.<sup>3</sup>

**(1) Unbundled Loops**

In setting prices for unbundled loops, the FCC failed to provide any reasoned explanation connecting the studies on which it relied either to its own pricing method or to the proxy prices ultimately imposed. The FCC's blithe disregard for the very methods it prescribed and its failure to explain the ultimate price levels it chose are, once again, prime exemplars of arbitrary agency action.

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<sup>3</sup> All discussion in this section is based on the attached affidavit of Dennis B. Trimble.

The FCC determined as a general matter that prices should be set based on the TELRIC of providing a particular network element plus a reasonable allocation of joint and common costs.<sup>4</sup> With respect to proxy prices for unbundled loops, the FCC explained that it was setting prices based on two cost models and on the rates for unbundled loops set by six states, including Florida, that had already conducted actual cost studies. See Interconnection Order, ¶ 792. The cost studies, however, and particularly the Florida studies, were not based on the FCC's new "TELRIC-plus an allocation for joint and common costs" method. To the contrary, the Florida studies used a measure of costs known as total service long run incremental cost ("TSLRIC") and omitted any significant contribution for joint and common costs. See FPSC Docket No. 950984-TP, Order No. PSC-96-0811-FOF-TP.

As the FCC itself has explained, TSLRIC will systematically produce lower cost estimates than the FCC's TELRIC method because it fails to capture as many joint and common costs and assign them to a particular service or element. See Interconnection Order, ¶ 695. In addition, unlike the FCC's stated method, the Florida studies did not include a further allocation of joint and common costs on top of the incremental costs that could be specifically assigned to loops. Despite the obvious discrepancies between the

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<sup>4</sup> TELRIC identifies the forward-looking costs attributable to an entire element in a LEC's network. Thus, in one sense, it identifies the costs that would be avoided if the LEC eliminated that element from its network. While some joint and common costs of the network that can be specifically allocated between discrete elements are included in TELRIC, the FCC recognized that TELRIC alone would leave joint and common costs unrecovered and thus required that a "reasonable allocation" of joint and common costs be considered on top of TELRIC in determining prices. See Interconnection Order ¶¶ 694-696.

standards used in Florida and its own methodology, the FCC made no effort to explain how the Florida studies might properly be used in setting rates that would comply with the FCC's declared approach.

The FCC only compounded its error by choosing, again without explanation, a proxy rate for Florida that could not even be reconciled with the Florida studies upon which the FCC allegedly based its proxy rates. Based on the studies presented to it, the Florida commission approved loop prices that produced an overall state weighted average price of \$17.28. Given the methods used in the Florida cost studies, the FCC's announced pricing method by definition would logically require an average loop price greater than \$17.28. Nevertheless, without any further explanation linking the price it selected to the Florida studies (or linking the studies to its own pricing standards), the FCC set the average proxy rate for loops in Florida at \$13.68 – more than 20% below the average rate set by Florida. On its face that result cannot be squared with the Florida studies, one of the few actual pieces of evidence concerning costs on which the FCC claimed it had relied. By declining to offer any rationale to explain this facially illogical result, the FCC utterly failed to live up to the requirements of reasoned decision making. See, e.g., Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983) (an agency must "examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made"); Competitive Telecommunications Ass'n v. FCC, 87 F.3d 522, 536 (D.C. Cir. 1996) (rejecting FCC rates because the "Commission did not give a reasoned explanation why its adoption [of an interconnection charge] was necessary or appropriate and consistent with the agency's

statutory responsibilities"). For all that appears from the explanation presented in the Interconnection Order, the FCC might just as well have picked the default prices out of a hat.

**(2) Unbundled Switching**

The FCC similarly failed to provide anything resembling a reasoned explanation for its approach to setting prices for unbundled switching. As defined by the FCC, the unbundled end office switching element includes not only the basic switching function of connecting lines and trunks but also the full range of "features, functions, and capabilities of the switch," Interconnection Order, ¶ 412, including "vertical switching features, such as custom calling and CLASS features." *Id.* ¶ 410. See also § 51.319(c). The studies on which the FCC relied to set proxy prices, however did not even purport to address the costs associated with providing end users the full functionality of the switch. Moreover, the studies considered only the incremental cost of additional minutes of traffic and made no attempt to measure average costs. Accordingly, the studies made no allowance for recovering overheads and fixed costs associated with the switch as explicitly allowed by the FCC's own declared pricing method. Nevertheless, the FCC once again failed to acknowledge the discrepancies between the evidence on which it was relying and its own definitions of both the network element in question and the proper measure of costs. In the absence of any effort to provide a rationale connecting these studies to the FCC's definitions, the FCC's reliance the studies as the source for the proxy prices is utterly arbitrary.

**(3) The Default and Proxy Rates Do Not Cover GTE's TELRIC Costs.**

As the attached Trimble affidavit demonstrates, when GTE adheres to the FCC's prescribed costing methodology, the costs that result are much higher than the mandatory proxy ceiling prices. Specifically, GTE's loop costs average at least 50 percent higher than the FCC's ceiling price, and GTE's unbundled end office switching costs average at least two-and-a-half times the FCC's price ceiling of \$0.004 per minute, even when all possible switching features and functions are not included. Moreover, as the Trimble affidavit shows, when GTE compares the revenues that would be obtained from the FCC's proxy prices to either the revenues from elements priced at the TELRICs computed by GTE or to current revenues per line, it is clear that a large gap exists. It is also obvious that the effective discount from the equivalent retail service price using the FCC proxy prices is much larger than the discount ceiling established by the FCC for resold services.

In these and other respects, the FCC's default proxy rates fail to compensate the LECs for their costs, even if those costs are viewed on a forward-looking basis. Accordingly, the FCC's rates violate the requirements of both the Act and the Takings Clause. As such, all requests by AT&T or MCI for establishment of the proxy rates should be summarily denied.

**C. BY IMPOSING THE FCC'S DEFAULT RATES, THIS STATE COMMISSION MAY BE RESPONSIBLE FOR AN UNCONSTITUTIONAL TAKING OF GTE'S PROPERTY.**

Both under the Act and under the Takings Clause, GTE is entitled to be compensated for the full cost of providing services and facilities. The Act states that rates

for interconnection and unbundled elements shall be "just" and "reasonable." Act, §§ 251(c)(2)(D), 251(c)(3). Such statutory language consistently is interpreted as being equivalent to the constitutional requirement that a utility receive sufficient compensation to avoid a taking. See, e.g., FPC v. Hope Natural Gas Co., 320 U.S. 591, 595 (1944); see also Jersey Central Power & Light Co. v. FERC, 810 F.2d 1168, 1175 (D.C. Cir. 1987) (explaining that Congressional standard "coincides with that of the Constitution"). This constitutional and statutory standard requires full compensation of cost. See, e.g., Brooks-Scanlon Co. v. Railroad Comm'n, 251 U.S. 396, 399 (1920) (Holmes, J.) ("a [regulated entity] cannot be compelled to carry on even a branch of business at a loss, much less the whole business . . ."); see also Norfolk & W. Ry. Co. v. Conley, 236 U.S. 605, 609 (1915) (explaining that a common carrier may not be required to transport a "commodity or class of traffic" at "less than cost"). The Act itself reinforces this requirement, by providing that rates for interconnection, unbundled elements, and resale all shall be based on "cost." See §§ 252(d)(1), 252(d)(3).

This Commission should be mindful that the FCC, by establishing default rates and requiring states to apply them only if states fail to complete their review of the state-specific cost and price-related issues, may well have shifted to this Commission the substantial risk of taking unconstitutionally GTE's property.<sup>5</sup> This is because under the mechanism set up by the FCC it is not the FCC but this Commission that is being asked ultimately to deny GTE and other LEC's just and reasonable compensation for their

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<sup>5</sup> The FCC has also committed an unconstitutional taking for the reasons, among others, detailed in GTE's motions and briefs seeking a stay of the FCC's First Report and Order.

services and network elements. In simpler terms, it is this Commission that must decide whether to adopt proxy rates to apply in this state -- not the FCC. GTE submits that no state commission should adopt rates that it has never heard evidence on, much less review the underlying assumptions and models supporting such rates.<sup>6</sup>

What is beyond dispute is that the default proxy rates set forth in the FCC's Interconnection Order fail to compensate GTE for its costs of providing services and facilities, even if costs are properly viewed only on a forward-looking basis. For example, the FCC's TELRIC methodology fails to allow GTE to recover its full joint and common costs. On its face, the FCC's rule provides for a "reasonable allocation of forward-looking joint and common costs." Interconnection Order, ¶ 672. In defining what allocation would be "reasonable," however, the FCC ensures that the LECs will not in fact be able to recover a large portion of their joint and common costs. The FCC determines that it would be reasonable to "allocate only a relatively small share of common costs to certain critical network elements, such as the local loop and collocation, that are most difficult for entrants to replicate," but that it would be unreasonable to allocate common costs "in inverse proportion to the sensitivity of demand for the various network elements and services." Id., ¶ 696. In plain English, GTE is free to allocate joint and common costs to network

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<sup>6</sup> The following example may help illustrate our point. Suppose that this Commission had to establish rates for an electric utility operating in this state, but the utility told the Commission that it should just "rubber stamp" the utility's proposed rates and not conduct a hearing because the rates were based on rates established a year ago by another state commission for another electric utility. Clearly, this Commission would refuse to do so. Nevertheless, this is precisely what AT&T and MCI are requesting here -- they want the Commission to adopt rates for this state that were based, in large part, on rates set by different commissions for different companies over different time periods using different models and assumptions.

elements on which the presence of competition will prevent GTE from being able to recover those costs, but GTE is not allowed to allocate significant common costs to those elements on which GTE has a good chance of recovering them in the marketplace. The FCC's "reasonable allocation" is, in reality, a sham for preventing LECs from recovering a large portion of their joint and common costs.

The FCC's new TELRIC methodology, moreover, expressly prohibits calculation of incremental costs based on the LEC's "existing network design and technology." *Id.*, ¶¶ 683-85. Instead, the FCC requires that LECs calculate "their" incremental costs based on the construction of a some hypothetically "most efficient technology" network, constructed consistent with the LEC's current wire center locations. *Id.* ¶ 685. In other words, a LEC will not be allowed to recover even its own actual incremental costs, but rather only the incremental costs of a hypothetically most efficient network based on the LEC's existing wire centers.

As the attached Trimble affidavit demonstrates, when GTE adheres to the FCC's prescribed costing methodology, the costs that result are much higher than the mandatory proxy ceiling prices. Specifically, GTE's loop costs average at least 50 percent larger than the FCC's ceiling price, and GTE's unbundled end office switching costs average at least two-and-a-half times the FCC's price ceiling of \$0.004 per minute, even when all possible switching features and functions are not included. Moreover, the Trimble affidavit shows, when GTE compares the revenues that would be obtained from the FCC's proxy prices to either the revenues from elements priced at the TELRICs computed by GTE or to current revenues per line, it is clear that a large gap exists. It is also obvious that the effective

discount from the equivalent retail service price using the FCC proxy prices is much larger than the discount ceiling established by the FCC for resold services.

In these and other respects, the FCC's default proxy rates fail to compensate the LECs for their costs, even if those costs are viewed on a forward-looking basis. Accordingly, the FCC's rates violate the requirements of both the Act and the Takings Clause.

**D. THE COMMISSION MAY NOT IMPOSE THE FCC'S DEFAULT PROXY RATES BECAUSE THEY ARE NOT YET LEGALLY EFFECTIVE.**

By seeking imposition of the proxy rates, AT&T and MCI ignore evidence regarding GTE's avoided retail costs for wholesale services and GTE's forward-looking costs for interconnection and unbundled elements. The FCC's Order, at this point, has no legal force whatsoever. The FCC's regulations provide that its orders are not effective until 30 days after publication in the Federal Register. This regulation is designed to give affected parties the ability to seek a stay of rules either from the FCC or from a Court. AT&T and MCI would have the Commission ignore these carefully designed procedures and pretend that the FCC's Interconnection Order is already effective and will never be reviewed. For this reason alone, the issue of default and proxy rates should be removed from the case at this time.

Moreover, the recognition and use of the default proxy rates would undermine the this Commission's pending challenge and motion for stay of the FCC's Order. This Commission, as well NARUC and other state utility commissions, have sought review of the Order on the grounds that the FCC overstepped its authority in purporting to

promulgate rates for intrastate services and facilities, which remain under state regulatory jurisdiction. If the Commission were to use default proxy rates to establish GTE's rates, the Commission's position that the FCC was without authority to promulgate such rates would be severely undermined. Accordingly, the Commission should remove the default and proxy rates from this proceeding.

**E. IF THE COMMISSION CANNOT COMPLETE ITS ANALYSIS WITHIN THE ACT'S TIMEFRAME, IT SHOULD ADOPT GTE'S PROPOSED RATES ON AN INTERIM BASIS SUBJECT TO REFUND**

If this Commission decides it cannot evaluate the cost and price-related materials presented in this arbitration within the timeframe established by the Act, then GTE respectfully requests that the Commission adopt GTE's proposed rates on an interim basis subject to refund. This proposal is consistent with traditional rate-making practice, and better balances the interests of all the parties. Unlike the proxy rates, GTE's rates are state-specific.

#### IV. CONCLUSION

For all these reasons, GTE respectfully requests that this Commission deny AT&T's and MCI's request for the imposition of default proxy rates and that it be compensated its actual costs incurred in delivering to AT&T services and network elements.

Respectfully submitted on September 20, 1996.

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Telephone: 813-228-3087

Attorneys for GTE Florida Incorporated

AFFIDAVIT OF DENNIS B. TRIMBLE

STATE OF TEXAS           §  
  §  
COUNTY OF DALLAS       §

Dennis B. Trimble, being duly sworn according to law, states as follows:

**I. INTRODUCTION**

1. My name is Dennis B. Trimble and I am the Assistant Vice President - Marketing Service (Acting) for GTE Telephone Operations ("GTE" or "the Company"). In that capacity I am responsible for, among other matters, analyzing the demand characteristics of GTE's regulated product offerings and developing costs, prices and associated tariff filings for all of GTE's regulated services, inclusive of tariff filing activity with the FCC.

2. I have over 20 years experience with GTE. During this time I have held various positions throughout the Company, almost all related to demand analysis, market research, forecasting, and/or the pricing of regulated telecommunication services. I have a B.A. in Business (1970) and an M.B.A. (1973) both from Washington State University. In 1972, I became an Assistant Professor at the University of Idaho, where I taught courses in statistics, operations research and decision theory. From 1973 through 1976, I completed course work toward a Ph.D. degree in Business at the University of Washington, majoring in quantitative methods with minors in computer science, research methods, and economics.

3. I have reviewed in detail the Federal Communications Commission's ("FCC") *First Report and Order* in CC Docket No. 96-98 which was issued on August 8, 1996. Among other things, the *First Report and Order* establishes a framework of national rules implementing the local competition provisions of the Telecommunications Act of 1996 ("Act") and adopts

default proxy ceiling prices that are to be used after an arbitration proceeding as the price for unbundled network elements and resold services unless a state regulatory agency has completed its review of studies that comport to the FCC's prescribed, new costing methodology (at ¶¶ 789-827).

4. The purpose of this affidavit is to present four basic points: (a) to describe the nature of the cost studies that GTE submitted in the Florida Public Service Commission's ("FPSC") proceeding No. 950985-TP, and that are referenced in the *First Report and Order* (at ¶¶ 793, 808) and why such studies were misused by the FCC; (b) to describe the magnitude of GTE's estimates of total joint and common costs that have resulted from the procedures employed by the Company in the development of its various Total Service Long Run Incremental Cost ("TSLRIC") estimates as submitted in various state proceedings; (c) to compare the results of cost studies prepared using the FCC's prescribed methodology that GTE has completed with the FCC's mandatory proxy price ceilings which shows that the TELRIC costs are not covered by the proxy rates even before common costs are considered; and (d) to demonstrate generically the shortfall a GTE Operating Telephone Company will experience by comparing the revenues that would be obtained using the FCC's proxy prices from an average customer (average residence or business) service in GTE's California service area to both the revenues generated from elements priced at GTE California Incorporated's TELRICs and to current average per line revenues. As the attached Exhibits 2 and 3 demonstrate, when GTE adheres to the FCC's prescribed costing methodology, the costs that result are much higher than the mandatory proxy ceiling prices. Specifically, GTE's loop costs average at least 50 percent larger than the FCC's ceiling price, and GTE's unbundled end office switching costs average at least two-and-a-half times the FCC's price ceiling of \$0.004 per minute, even when all possible

switching features and functions are not included. Moreover, as Exhibit 4 shows, when GTE compares the revenues that would be obtained from the FCC's proxy prices to either the revenues from elements priced at the TELRICs computed by GTE or to current revenues per line, it is clear that a large gap exists. It is also obvious that the effective discount from the equivalent retail service price using the FCC proxy prices is much larger than the discount ceiling established by the FCC for resold services.

## **II. DESCRIPTION OF THE FLORIDA COST STUDIES AND WHY THEY DO NOT SUPPORT THE DEFAULT AND PROXY RATES ESTABLISHED BY THE FCC**

5. The cost studies that GTE submitted in the Florida Public Service Commission's Docket No. 950985-TP were only intended to identify the TSLRIC cost of local loops (both bundled and unbundled) and end office switching. As described below, there are substantive differences between the methodology used in GTE's Florida study and the FCC's Total Element Long Run Incremental Cost ("TELRIC") methodology. The results of GTE's Florida study cannot in any way be construed to produce a result that approximates a TELRIC-based cost that would be appropriate for use in deriving a proxy cost ceiling.

6. The FCC has prescribed that the pricing of network elements shall be based on the TELRIC of the element plus a reasonable share of forward looking joint and common costs. *See* § 51.505.

7. The FCC further defines a reasonable share of forward looking joint and common costs in the development of unbundled network element prices to depend on many factors including the Stand Alone Cost ("SAC") of the element, market demand characteristics, as well as the overall magnitude of the company's forward looking common costs. *First Report and Order* at ¶¶ 694, 695, 696, 698, 699.

8. GTE defines TSLRIC as the additional cost incurred by the Company to produce the entire output of a particular service, holding constant the production of all other services produced by the Company. While this definition is similar to the FCC's implied definition of TELRIC, the FCC has stated that many of the costs that are correctly defined as joint and common costs in the development of TSLRICs can be directly attributed to specific network elements in the development of TELRICs. *First Report and Order* at ¶¶ 678, 682, 694. Thus, the FCC's definition of TELRIC should result in cost estimates that are larger than the TSLRIC for the specific network function that is being studied.

### III. THE MAGNITUDE OF GTE'S JOINT AND COMMON COSTS

9. GTE's current TSLRIC methodology for services and unbundled elements includes the following expenses: (a) depreciation, (b) return on investment, (c) income taxes, (d) plant specific maintenance and repair, (e) central office land and buildings, (f) customer operations (*e.g.*, sales), and (g) miscellaneous fees and taxes (*e.g.*, ad valorem tax, gross receipts tax). GTE's TSLRIC methodology does not include the following expense items (they are considered common expenses to the Company): (a) plant specific expenses (*e.g.*, network support, general support, and general purpose computers), (b) plant non-specific expenses (*e.g.*, network planning, engineering), (c) general support assets (*e.g.*, furniture, office support equipment, company communications equipment, and general purpose computers), (d) land and buildings (other than central offices), (e) indirect labor, (f) corporate expenses, and (g) other taxes and fees, such as local franchise taxes, federal superfund taxes, local and state business license and occupation taxes). It is not unusual for these expense categories to represent from 35% to 45% of the Company's total accounting costs. The total amounts in these common cost

categories are appropriately excluded from GTE's TSLRIC studies because GTE's USOA-based accounting system records do not contain sufficient information to directly attribute (if appropriate) any of these expenses to specific network elements, and/or there is not a cost-causative method to associate these to specific elements of the network. The USOA-driven accounts, which GTE has identified as representing common costs, might include many items that are, in reality, service (or element) specific. However, as I have previously stated, those costs cannot be separately identified because the USOA-based accounting system does not contain a level of detail sufficient to allow direct attribution of those costs to their appropriate service (or network element). Thus, the USOA-based accounting processes limit GTE from identifying any remaining costs that may belong in the FCC's definition of TELRIC.<sup>1</sup> Paragraph 694 of the *First Report and Order* states: "Certain common costs are incurred in the provision of network elements. As discussed above, some of these costs are common to only a subset of the elements or services provided by the incumbent LEC's. Such costs shall be allocated to that subset, and should then be allocated among the individual elements of services in that subset, to the greatest possible extent" (*Emphasis added*). GTE's TSLRIC studies do not attempt to perform this allocation of common costs. Allocation of these common costs to specific products for recovery is accomplished through GTE's pricing activities, not through GTE's incremental costing activities. Thus, GTE's TSLRIC methodologies (as currently employed) will lead to incremental cost estimates that are likely to be substantially below what the FCC intended to be

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<sup>1</sup> It is my professional opinion, that even if GTE possessed an elaborate (and expensive) managerial accounting system that facilitated the direct assignment (when appropriate) of these costs, that GTE considers as common costs, to specific network elements, that this ability would only result in a minor change in the level of GTE's "total" common costs. I believe that the USOA accounts that GTE currently incorporate in its TSLRIC studies represent a vast majority of all directly assignable costs.

incorporated in the development of TELRICs. It is my belief that the FCC has relied upon benchmark prices (and/or costs), as filed in various states, that do not incorporate an allocation of common costs, and thus only represent the incremental cost of a network element and not the total, average cost of that element.

10. As I stated previously, the methodology GTE currently employs to develop its TSLRIC estimates does not incorporate significant levels of joint and common costs. These costs must be recovered through the pricing of services. For California, I submitted testimony that GTE California's forward looking joint and common costs were approximately \$1.05 billion annually,<sup>2</sup> which equated to 70% of the total costs identified in GTE's filed TSLRIC estimates. (Thus, GTE California's total economic costs could be recovered by pricing all network elements so that they achieved an average 70% markup over their TSLRIC estimates).

#### **IV. SPECIFIC ERRORS ASSOCIATED WITH THE FCC'S USE OF THE FLORIDA LOOP COST STUDIES**

11. In the development of its unbundled loop proxy price (ceiling price) for Florida, the FCC weighted the interim 2-wire unbundled loop rates for Bell South (\$17.00) and United/Centel (\$15.00) and the approved rate for GTE (\$20.00) as set by the Florida Public Service Commission (FPSC); and computed a state-wide average price of \$17.28 based upon the Florida figures. *First Report and Order* at ¶¶ 792, 793. The FCC assumed that the rates ordered by the FPSC were rational proxies for TELRIC plus a reasonable allocation of forward-looking common costs. But, GTEFL's approved rate of \$20.00 provides only an insignificant contribution to common costs (approximately 2% above GTEFL's filed TSLRIC estimate and

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<sup>2</sup> Source: Rebuttal Testimony of Dennis B. Trimble (Exhibit 313-S, filed July 10, 1996) before the California Public Utilities Commission in Docket No. R.93-04-003/I.93.04.002.

far below the average 70% that would be required in California). The FPSC's order that prescribed GTEFL's \$20.00 unbundled loop rate specifically stated "that GTEFL's rates for unbundled loops shall approximate TSLRIC" (Docket No. 950984-TP, Order No. PSC-96-0811-FOF-TP, page 31). There was no recognition of reasonable contribution to forward-looking common costs, as discussed by the FCC.

12. United/Centel's cost study for an unbundled loop was found by the FPSC to be inadequate to support the development of rates for an unbundled loop as the costs could not be identified as either LRIC or TSLRIC estimates. Based on judgment, the FPSC set an interim rate of \$15.00 for United/Centel and also ordered United/Centel to complete appropriate cost studies (Docket No. 950984-TP, Order No. PSC-96-0811-FOF-TP, page 32). The FCC assumed that the \$15.00 rate set by the FPSC is a reasonable depiction of United/Centel's TELRIC plus "reasonable allocation of forward-looking common costs" as is required by § 51.505(a)(2). But as noted above, in setting loop rates the FPSC did not include any reasonable contribution to forward-looking common costs.

13. Likewise, the FPSC found Bell South's filed cost studies for unbundled elements to be deficient which led the FPSC to set an interim rate of \$17.00 for Bell South's unbundled 2-wire loop. Bell South was also ordered to file cost studies to support the development of a permanent unbundled loop rate (Docket No. 950984-TP, Order No. PSC-96-0444-FOF-TP, page 19).

14. To meet its own criteria, the FCC's proxy prices should be constructed to reasonably reflect statewide average TELRIC plus a "reasonable allocation of forward-looking common costs." However, in the development of Florida's proxy price for unbundled 2-wire loops the FCC relied on FPSC ordered rates. Of the three rates used by the FCC, only GTE's

rate had any accepted cost support. Moreover, even GTE's rate did not contain any reasonable contribution as toward joint and common costs as required under the FCC's own pricing guidelines. § 51.505 The FPSC's ordered rates were intended to have little or no contribution above TSLRIC. When this fact is combined with the fact that TELRIC should be higher than TSLRIC (*First Report and Order* at ¶ 678), the obvious conclusion is that the proxy ceiling of \$17.28 that the FCC found the studies produce for Florida is too low and that it cannot be construed to be an estimate of TELRIC plus a "reasonable allocation of forward-looking common costs" as is required by § 51.505(a)(2). But the FCC did not use this rate. Instead, its proposed proxy ceiling rate for Florida of \$13.68 is apparently calculated from another model using the unweighted approved Florida rates as a scaling factor. (*Id.* at ¶ 794) The FCC's proxy ceiling for unbundled loops in Florida can only be considered arbitrary and inappropriate.

#### **V. SPECIFIC ERRORS ASSOCIATED WITH THE FCC'S USE OF FLORIDA'S UNBUNDLED SWITCHING COST STUDIES**

15. For unbundled switching, the Commission defined the local unbundled switching element to encompass line-side and trunk-side facilities plus all of the features, functions, and capabilities of the switch. (*Id.* at ¶ 412) The line-side facilities include the connection between a loop termination at, for example, a main frame distribution frame (MDF), and a switch line card. The trunk-side facilities include the connection between, for example, trunk termination at a trunk-side cross-connect panel and a trunk card. The "features, functions, and capabilities" of the local switch include the basic switching function of connecting lines to lines, lines to trunks, trunks to lines, trunks to trunks. It also includes the same basic capabilities that are available to the incumbent LEC's customers, such as a telephone number, directory listing, dial tone, signaling, and access to 911, operator services, and directory assistance. In addition, the local

switching element includes all vertical features that the switch is capable of providing, including custom calling, CLASS features, and Centrex, as well as any technically feasible customized routing functions.

16. In the *First Report and Order* (at ¶ 803), the Commission discusses the estimates of the cost for end-office switching. The Commission also discusses the costs and rates for transporting and terminating traffic for interconnection purposes and concludes, that a range between 0.2 cents (\$0.002) per minute of use and .4 cents (\$0.004) per minute of use for unbundled local switching is a reasonable default proxy. (*Id.* at ¶¶ 805-809, 811) Thus, the Commission reasoned: “We, therefore, conclude that 0.2 cents (\$0.002) per minute of use is a reasonable lower end of the price for end-office switching.” (*Id.* at ¶ 812)

17. A review of the record relied upon by the Commission in determining the range of proxy rates for the unbundled local element defined in § 51.513 for local switching demonstrates that the Commission used incomplete data for the costs for end-office switching and local interconnection. The costs for the functions that support the rates for end-office switching and local interconnection simply do not match the description of the unbundled local switching element the Commission has laid out. (*First Report and Order* at ¶ 412) The cost studies on which the Commission relied measure only the incremental cost of end office switching for local interconnection. End office switching used for local interconnection only includes the basic switching function of connecting lines to trunks and trunks to lines. There is no cost or rate evidence in the record regarding the remaining features, functions, and capabilities of the switch that are included in the Commission’s definition of the unbundled switching element. By relying on studies that take into account the cost of only a fraction of the

switching element as defined in the rules, the FCC has established an unreasonably low proxy rate for the local switching element.

18. For unbundled end office switching, the difference between the FCC's objective TELRIC costs and the GTE study filed in Florida are significant. These crucial differences are:

a. First and foremost, the GTE study did not attempt to determine the cost of unbundled end office switching that would be used by a requesting party to provide local exchange service. The study determined only the incremental costs associated with terminating an additional minute of use when two networks are interconnected for the purpose of exchanging traffic,

b. At the time GTE filed its study in Florida it did not have the procedures in place to identify the fixed costs associated with central office land and buildings. As a result, these expenses were not included in GTE's TSLRIC study filed in Florida. This expense item, which is now included on a going-forward basis in GTE's TSLRIC studies, is a significant contributor to the average cost of end-office switching. Central office land and buildings expenses can account for up to 60% of the total TSLRIC of end-office switching.

c. As discussed in paragraph 9 of this Affidavit, GTE's procedure for estimating TSLRICs tends to exclude costs (which GTE has termed as joint and common) that properly belong in what the FCC defines as TELRIC. Again, this further supports the conclusion that GTE's TSLRIC estimates, as filed in Florida, are likely to dramatically understate what the FCC would term a TELRIC estimate, and would be far less than an estimate of TELRIC plus "a reasonable allocation of forward-looking common costs." § 51.505(a)(2).

Thus, the numbers on which the FCC relied upon are too low because they were based on GTE Florida filed estimates. *First Report and Order* at ¶ 808. By relying on such figures that did not include all of the costs included in the Commission's own TELRIC methodology, the FCC has picked a benchmark number for end-office switching costs that is significantly under-stated.

19. To illustrate this fact, an analysis prepared under my direction compares the FCC's proxy ceiling price for unbundled switching to the actual cost of providing that unbundled feature. This was done by selecting two typical local central office switches and determining the cost per year to operate those switches. The costs are for maintenance, support structures, capital costs, and an average distribution of overheads. These are all costs that the FCC has specified as being appropriate for inclusion in unbundled elements. *See First Report and Order* at ¶¶ 682, 691. These current costs were reduced by 17% of total revenues based upon the FCC's estimate of costs that would be avoided if an ILEC were not in the retail business.<sup>3</sup> The appropriate unit of analysis is the entire central office switch, because the FCC specified the party obtaining a unit of unbundled switching will also have access to all of the features and functions of the switch. The results of the switching cost analysis are shown on Exhibit 1.

## **VI. THE FCC'S DEFAULT AND PROXY RATES DO NOT COVER GTE'S TELRIC COSTS**

20. The switching cost analysis shows that, at a price per minute ranging from \$.002 to \$.004 (the FCC specified proxy ceiling price), the total revenue that would be generated by applying those prices to all local and access minutes of use falls well short of recovering the

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<sup>3</sup> From the studies I have reviewed, I believe the costs avoided are less than this amount, but this amount was used to base the analysis on the FCC's own cost avoidance projection.

actual costs of providing the unbundled switching element.<sup>4</sup> The shortfall results from a reliance by the FCC upon cost studies presented to, or decisions made by, state commissions that were designed to estimate the incremental cost of switching one minute of calling exchanged between two networks that are interconnected.

21. GTE's TELRIC cost studies are based upon the methodology prescribed by the *First Report and Order* (at ¶¶ 672-702). GTE first calculated the direct forward-looking cost of each network element. GTE then determined the common costs that could not be attributed to any particular element or sub-group of elements. According to the FCC's methodology, these latter costs are to be allocated to all network elements during the pricing process.

22. The *First Report and Order* specified (at ¶ 744) that the rate for unbundled local loops be a flat, per-month charge. Further, the FCC specified (at ¶ 794, Appendix D) the statewide average ceiling price that a state regulatory agency could adopt in an arbitration proceeding unless the state commission had completed its review of cost studies that comport to the FCC methodology. Exhibit 2 shows the results of the GTE cost studies for loops in several states where GTE serves a large number of customers. The cost developed using a TELRIC methodology averages 50 percent larger than the FCC's proxy ceiling price. This difference clearly supports my conclusion that the FCC's loop proxy price is arbitrary and inappropriate because it is based upon a mixture of cost estimates for only the bare incremental cost of a loop, rather than being based upon a TELRIC methodology. Further, to assure a proper comparison, neither the proxy price nor the GTE TELRIC results described above include any allocation of common costs as the FCC's own cost methodology requires .

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<sup>4</sup> As depicted by “% UNRECOVERED USING PROXY” line on Exhibit 1.

23. The *First Report and Order* specified (at ¶ 412) that the unbundled local switching network element is to include not only line-to-line and line-to-trunk "basic switching," but also all of the features, functions, and capabilities, such as a telephone number, directory listing, dial tone, signaling, and access to 911, operator services and directory assistance, all vertical features including custom calling and CLASS features, Centrex, and any technically feasible customized routing functions. The unbundled local switching rate structure is required to include "a combination of a flat-rated charge for line ports, which are dedicated to a single new entrant, and either a flat-rate or per-minute usage charge for the switching matrix and for trunk ports, which constitute shared facilities, best reflects the way costs for unbundled local switching are incurred." *Id.* at ¶ 810. Unless a state regulatory agency has completed its review of cost studies that comport with the FCC's costing methodology, state agencies are required (*Id.* at ¶ 815) to set the rate for unbundled local switching "so that the sum of the flat-rated charge for line ports and the product of the projected minutes of use per port and the usage-sensitive charges for switching and trunk ports, all divided by the projected minutes of use, does not exceed 0.4 cents (\$0.004) per minute of use and is not lower than 0.2 cents (\$0.002) per minute of use."

24. Exhibit 3 compares the FCC's proxy price for unbundled local switching to the results of cost studies prepared by GTE using the FCC's TELRIC methodology. Shown are GTE's cost estimates for three end office switching cost elements for a number of states where GTE serves a large number of customers. Those elements are: (i) a per minute cost to switch a call; (ii) a per line per month cost for the non-usage sensitive components of a switch (*e.g.*, line card); and (iii) a per line per month cost for a representative feature package. The cost element of a per line, per month cost for the feature package was chosen to comply with the FCC's

mandate that a rate structure recover costs "in a manner that efficiently apportions costs among users." *First Report and Order* at ¶ 755. It is very important to note that the feature package selected for illustrative purposes does not include all of the features, functions and capabilities that a switch may be capable of providing. The package selected includes only many of the most commonly used features (*e.g.*, Call Waiting, Emergency Bureau Access, Speed Calling, Time of Day Routing). Also not included in any of the three cost estimates in Exhibit 3 are the costs associated with a directory listing or the more esoteric switch features such as customized routing and Meet-Me Conference Bridging. The feature package used in calculating the cost for two states shown in Exhibit 3, Ohio and Wisconsin, did include additional, more advanced features, just to show the potential cost impact on a per minute basis.

25. To provide a logical comparison, GTE converted the two per line, per month cost elements into an equivalent per minute cost by dividing by the average switched minutes of use per month, including minutes associated with both local and long distance calls. The result of this calculation is a composite TELRIC per minute cost that is three-and-a-half times the FCC's upper price ceiling of \$0.004, even when ignoring the two states with feature packages that include extraordinary features. These results confirm my conclusion that the FCC's local switching proxy price was based upon information that estimated the incremental cost of line-to-line or line-to-trunk basic switching, but did not, as the FCC's own methodology requires, include either the costs related to other switch features and functions, or common costs.

## **VII. THE DEFAULT AND PROXY RATES CREATE A SEVERE REVENUE SHORTFALL TO THE GTOCS**

26. Exhibit 4 compares the FCC's proxy price for a combination of unbundled local switching and an unbundled local loop (*i.e.*, the reassembled equivalent of local service) to both

the results of a GTE California ("GTEC") TELRIC study, and to current average revenues per line in California. To prepare this comparison, GTE derived the average monthly usage per line, including local and toll minutes of use, for an average of residence and business lines. This average number of minutes was multiplied by the FCC's proxy price ceiling of \$0.004 per minute, and that switched usage revenue amount was added to the flat rate components that would also be needed to comprise reassembled local service (*i.e.*, a local loop and a Network Interface Device, or "NID"). GTE also derived the current revenues per line for an average of California residence and business lines, including flat rate local charges, local and toll usage charges, and vertical feature charges. When the unbundled network elements of switching, a loop and a NID are combined to replicate local service, the revenues from those elements when priced at the FCC's proxy rates are approximately half of GTEC's TELRIC for the combined service (Exhibit 4, \$18.88 compared to \$36.35 per month). This comparison of price to cost understates the shortfall, because by definition TELRIC does not include an allocation of common costs. Further, the FCC's proxy prices would provide new entrants with approximately a 60 percent discount off GTEC's current average retail revenue per line in California (Exhibit 3, \$18.88 compared to \$46.31 per month). Clearly neither the FCC proxy price nor the TELRIC methodology come anywhere close to providing revenues that cover GTE's cost of providing service.

27. Moreover, the 60 percent discount that results from the FCC proxy price cannot be squared with the FCC's interim wholesale rates. Section 51.611 of the FCC's rules requires that resale discounts should be "no more than 25 percent." Thus, the FCC's proposed requirements for its two pricing mechanisms (resale and unbundling) are totally inconsistent.

The potential discount is significantly below the Company's costs and would result in GTE subsidizing competitive entry.

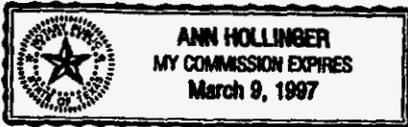
28. Based upon my and my staff's review of the FCC's *First Report and Order*, I am convinced that the FCC's proxy price ceilings for unbundled loops and local switching are significantly understated and in absolute conflict with §§ 51.319(c)(1)(C), 51.503 and 51.505.

Dennis B. Trimble  
Dennis B. Trimble

NOTARY Ann Hollinger  
Signature

Ann Hollinger  
Printed Name

SEAL



Date 9-17-96

**Exhibit 1**

**Supplemental Affidavit of Dennis B. Trimble**

**Central Office Analysis**

CENTRAL OFFICE ANALYSIS

ITEM	SAN ANGELO SE		AZLE	
	@ .004/MIN	@ .002/MIN	@.004/MIN	@ .002/MIN
LINES	17,458	17,458	6,619	6,619
SWITCH INVESTMENT	\$7,045,234	\$7,045,234	\$3,210,000	\$3,210,000
MINUTES/MONTH	10,893,753	10,893,753	11,811,072	11,811,072 ←
ANNUAL COSTS				
OPERATING EXPENSES				
MAINTENANCE	\$569,748	\$569,748	\$259,593	\$259,593
ADMIN AND OVERHEAD	\$1,003,101	\$1,003,101	\$457,039	\$457,039
DEPRECIATION	\$177,188	\$177,188	\$80,732	\$80,732
RETURN ON INVEST.	\$778,498	\$778,498	\$354,705	\$354,705
COMPOSITE TAX	\$59,532	\$59,532	\$27,125	\$27,125
LAND & BUILDINGS	\$679,865	\$679,865	\$309,765	\$309,765
PROPERTY TAX	\$69,043	\$69,043	\$31,458	\$31,458
TOTAL ANNUAL COST	\$3,336,975	\$3,336,975	\$1,520,417	\$1,520,417
LESS 17% AVOIDED	\$567,286	\$567,286	\$258,471	\$258,471
ADJUSTED ANNUAL COST	\$2,769,689	\$2,769,689	\$1,261,946	\$1,261,946
COST/MO (ANN. COST/12)	\$230,807	\$230,807	\$105,162	\$105,162
TELRIC/MIN	\$0.004	\$0.002	\$0.004	\$0.002
USAGE REV/MO	\$43,575	\$21,788	\$47,244	\$23,622
COMMON COST/MO	\$187,232	\$209,020	\$57,918	\$81,540
COMMON COST/LINE/MO	\$10.72	\$11.97	\$8.75	\$12.32
% UNRECOVERED USING PROXY	81.1%	90.6%	55.1%	77.5%

**Exhibit 2**

**Supplemental Affidavit of Dennis B. Trimble**

**Comparison of Loop Proxy Price Ceilings  
with  
Costs Developed  
Using the FCC's Prescribed Methodology**

Exhibit 2

**LOOPS**

STATE	FCC LOOP PROXY CEILING PRICE (a)	GTE's TELRIC UNBUNDLED LOOP (b)	RATIO: PROXY PRICE TO TELRIC (c = b / a)	BCM II COST * (e)	RATIO: PROXY PRICE TO BCM II (f = e / a)
California	\$11.10	\$23.09	2.08	\$21.56	1.94
Florida	\$13.68	\$21.94	1.60	\$25.44	1.86
Hawaii	\$15.27	\$18.66	1.22	\$25.72	1.68
Illinois	\$13.12	\$22.82	1.74	\$34.43	2.62
Michigan	\$15.27	\$19.54	1.28	\$37.00	2.42
Ohio	\$15.73	\$20.28	1.29	\$36.00	2.29
Pennsylvania	\$12.30	\$19.04	1.55	\$29.07	2.36
Texas	\$15.49	\$22.46	1.45	\$28.98	1.87
Washington	\$13.37	\$22.20	1.66	\$28.23	2.11
Wisconsin	\$15.94	\$19.15	1.20	\$39.05	2.45

- GTE analysis indicates that the BCM II default assumptions cause its resulting loop cost to be understated by as much as \$5 to \$10 per loop, depending on the state. For example, the default assumptions for conduit and drop wire installation costs are much lower than a contract GTE had with Lucent Technologies for those activities. Note also that BCM II includes an allocation of common costs.

**Exhibit 3**

**Supplemental Affidavit of Dennis B. Trimble**

**Comparison of End Office Switching Proxy Price Ceilings  
with  
Costs Developed  
Using the FCC's Prescribed Methodology**

Exhibit 3

**END OFFICE SWITCHING**

STATE	TELRIC PER MINUTE (a)	TELRIC PER PORT (b)	TELRIC FEATURE PACKAGE (c)	COMPOSITE TELRIC PER MINUTE (d = a + ((b + c / MOU))	RATIO: TELRIC TO FCC \$0.004 UPPER BOUND (e=d/\$0.004)
California	0.0034840	\$4.63	\$2.61	\$0.0107	2.68
Florida	0.0033592	\$4.51	\$6.90	\$0.0179	4.47
Hawaii	0.0073493	\$5.22	\$6.69	\$0.0244	6.09
Illinois	0.0041515	\$3.78	\$2.02	\$0.0106	2.65
Michigan	0.0031419	\$3.63	\$4.06	\$0.0119	2.99
Ohio *	0.0030980	\$4.46	\$15.29	\$0.0262	6.54
Pennsylvania	0.0027488	\$4.79	\$2.39	\$0.0120	2.99
Texas	0.0035126	\$4.39	\$4.90	\$0.0147	3.68
Washington	0.0034332	\$3.15	\$2.08	\$0.0096	2.40
Wisconsin *	0.0028151	\$4.58	\$10.04	\$0.0208	5.21

\* Nonstandard feature packages

**Exhibit 4**

**Supplemental Affidavit of Dennis B. Trimble**

**Comparison of Loop and Switching Proxy Prices  
with  
Costs Developed Using the FCC's Prescribed Methodology  
and with  
Current Average Revenues per Line in California**

**COMPARISON OF PROXY PRICES  
WITH  
GTE CALIFORNIA TELRIC AND REVENUES**

	TELRIC	FCC Proxy Prices	Current GTE Avg Rev per Line per Mo	
Local Loop	\$23.09	\$11.10	Local Service Price	\$21.53
Network Interface Device	\$2.54	\$2.54	Switched Access	\$6.28
Switching	\$10.72	\$4.00	100% TIC	\$1.65
75% TIC	n/a	\$1.24	Local Switching	\$4.12
			Vertical Services	\$1.92
			IntraLATA Toll	\$10.80
Per Line	\$36.35	\$18.88	Total Revenues	\$46.31

Notes: Switched access transport excluded from costs & revenues above.  
 Carrier Common Line Charge revenues excluded from all calculations.  
 Subscriber Line Charge revenues included in average rate per switched access line.  
 TIC = Transport Interconnection Charge

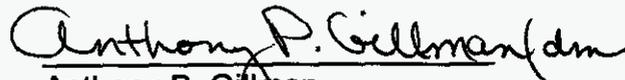
**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that copies of GTE Florida Incorporated's Motion to Deny AT&T's Request Regarding Implementation of the FCC's Default Proxy Rates and Brief in support thereof in Docket Nos. 960847-TP and 960980-TP were hand-delivered (\*) or sent via overnight mail (\*\*\*) on September 20, 1996 to the parties listed below.

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