

1 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

2

3 In the Matter of)

4 Determination of the cost of) DOCKET NO. 980696-TP

5 basic local telecommunications)

6 services, pursuant to)

 Section 364.025, Florida)

 Statutes.)

7

8

9

10 VOLUME 5

11 Pages 593 through 736

12 PROCEEDINGS:

HEARING

13 BEFORE:

CHAIRMAN JULIA L. JOHNSON
 COMMISSIONER J. TERRY DEASON
 COMMISSIONER SUSAN F. CLARK
 COMMISSIONER E. LEON JACOBS, JR.
 COMMISSIONER JOE GARCIA

16 DATE:

Monday, October 12, 1998

17 TIME:

Commenced at 1:00 p.m.

18 PLACE:

Betty Easley Conference Center
 Room 148
 4075 Esplanade Way
 Tallahassee, Florida

21 REPORTED BY:

NANCY S. METZKE, RPR, CCR

23 APPEARANCES:

24 (As heretofore noted.)

25 BUREAU OF REPORTING

RECEIVED 10-13-96

DOCUMENT NUMBER-DATE

1-1395 OCT 13 98

FTS-RECORDS/REPORTING

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1 P R O C E E D I N G S

2 (Transcript follows in sequence from Volume 4)

3 CHAIRMAN JOHNSON: We are going to go back on the
4 record. We're going to go back on the record. One
5 preliminary announcement. Tomorrow we had scheduled to
6 take the afternoon for a special agenda. That special
7 agenda is going to be deferred so that we will have
8 tomorrow afternoon to take witnesses. You all may want to
9 get together and determine who can go when and make sure
10 there are no conflicts and let us know at the appropriate
11 time.

12 Staff.

13 MR. COX: During the break the parties have
14 brought up a preliminary matter that they would like to
15 bring up before we begin the procession of witnesses
16 involving the order of questioning by the parties on cross
17 examination.

18 MR. FONS: Chairman Johnson, John Fons. The
19 parties have agreed that for purposes of cross examination
20 the parties that have put on the witness will go first with
21 any cross examination, and then the opposing parties will
22 then have cross examination after the parties who put on
23 the witness. For example, Don Wood, when he is on, all of
24 the IXEs will do their cross, and then the LECs will do
25 their cross; and then staff, obviously, will come last.

1 CHAIRMAN JOHNSON: Okay.

2 MR. FONS: If that's okay with the Commission.

3 CHAIRMAN JOHNSON: That will work.

4 MS. CASWELL: Chairman Johnson.

5 COMMISSIONER CLARK: I just have a question. Who
6 sponsored Mr. Wood?

7 MR. FONS: AT&T and MCI, but he is speaking on
8 behalf of the IXE industry.

9 COMMISSIONER CLARK: So AT&T and MCI would not
10 cross examine.

11 MR. FONS: I understand that, but I mean the
12 other IXE.

13 COMMISSIONER CLARK: Okay.

14 CHAIRMAN JOHNSON: Ms. Caswell.

15 MS. CASWELL: Yeah, I just have one other
16 preliminary matter. I have two additional appearances to
17 make for my outside counsel. They were not here this
18 morning. But their names are John Williams and Tom
19 Mitchell.

20 CHAIRMAN JOHNSON: And Tom who?

21 MS. CASWELL: Tom Mitchell.

22 CHAIRMAN JOHNSON: Mitchell.

23 MS. CASWELL: They are both from Collier,
24 Shannon, Rill & Scott in Washington, DC. They are members
25 of DC bar. They've practiced before numerous state

1 commissions as well as state and federal courts.

2 CHAIRMAN JOHNSON: Thank you, Ms. Caswell.

3 MS. CASWELL: Thank you.

4 CHAIRMAN JOHNSON: Any other preliminary matters,
5 Staff?

6 MR. COX: Staff isn't aware of any.

7 CHAIRMAN JOHNSON: Okay.

8 COMMISSIONER GARCIA: The FCC calls Joseph
9 Gillan.

10 CHAIRMAN JOHNSON: I'll go ahead and swear all of
11 the witnesses in at this time. All of the witnesses that
12 are here to testify, if you could raise your right hand.

13 (WHEREUPON, THE WITNESSES PRESENT WERE DULY SWORN
14 BY CHAIRMAN JOHNSON)

15 MR. McGLOTHLIN: While Mr. Gillan is getting
16 ready, I want to remind the commissioners that it was
17 agreed that he would present both direct and rebuttal
18 testimony in this appearance.

19 Whereupon,

20 JOSEPH GILLAN

21 was called as a witness on behalf of FCCA and, having been
22 duly sworn, testified as follows:

23 DIRECT EXAMINATION

24 BY MR. McGLOTHLIN:

25 Q Please state your name and business address.

1 A Joseph Gillan, P.O. Box 541038, Orlando, Florida,
2 32854.

3 Q And for whom do you appear today, sir?

4 A The Florida Competitor Carriers Association.

5 Q Have you prepared direct testimony and submitted
6 it in this docket?

7 A Yes.

8 Q Do you have any changes or additions to that
9 direct testimony?

10 A No.

11 Q Do you adopt it as your testimony today?

12 A Yes.

13 MR. MCGLOTHLIN: Chairman Johnson, I request that
14 the direct testimony be inserted as though read at this
15 point.

16 CHAIRMAN JOHNSON: It will be so inserted.

17

18

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25

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Determination of the Cost of)	
Basic Local Telecommunications)	Docket No. 980696-TP
Service, Pursuant to Section 364.025,)	
Florida Statutes.)	Filed: August 3, 1998
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**DIRECT TESTIMONY OF
JOSEPH GILLAN
ON BEHALF OF
THE FLORIDA COMPETITIVE CARRIERS ASSOCIATION**

I. Introduction

1 **Q. Please state your name, business address and occupation.**

2

3 **A. My name is Joseph Gillan. My business address is P.O. Box 541038, Orlando, Florida**
4 **32854. I am an economist with a consulting practice specializing in telecommunications.**

5

6 **Q. Please briefly outline your educational background and related experience.**

7

8 **A. I am a graduate of the University of Wyoming, where I received B.A. and M.A. degrees**
9 **in economics. From 1980 to 1985, I was on the staff of the Illinois Commerce**
10 **Commission, where I had responsibility for the policy analysis of issues created by the**
11 **emergence of competition in regulated markets, in particular the telecommunications**
12 **industry. While at the Commission, I served on the staff subcommittee for the NARUC**
13 **Communications Committee and was appointed to the Research Advisory Council**
14 **overseeing NARUC's research arm, the National Regulatory Research Institute.**

1 In 1985, I left the Commission to join U.S. Switch, a venture firm organized to develop
2 interexchange access networks in partnership with independent local telephone
3 companies. At the end of 1986, I resigned my position of Vice President-
4 Marketing/Strategic Planning to begin a consulting practice. Over the past decade, I
5 have provided testimony before more than 25 state commissions, four state legislatures,
6 the Federal-State Joint Board on Separations Reform, and the Commerce Committee of
7 the United States Senate. I currently serve on the Advisory Council to New Mexico
8 State University's Center for Regulation.

9
10 **Q. On whose behalf are you testifying?**

11
12 **A.** I am testifying on behalf of the Florida Competitive Carriers Association (FCCA). The
13 FCCA represents a broad range of telecommunications carriers striving to provide
14 competitive local and long distance services throughout the State of Florida. FCCA's
15 members are committed to the continued realization of that goal commonly known as
16 "universal service" -- a goal which, quite candidly, equates to the largest possible base
17 of potential customers for their services. It is FCCA's basic view that standard
18 commercial incentives (i.e., profit) are the principal motivator for "universal service" and
19 additional subsidy should be the exception and not the rule.

20

1 Q. What is the purpose of your testimony?

2

3 A. The central goal of this proceeding is to determine the underlying cost of the network
4 facilities used to provide local exchange service in Florida. As the Commission
5 approaches this technical task, however, it is important to have the right of the purpose
6 behind the exercise. The study that the Commission adopts here must accurately
7 estimate the cost of the exchange network, and it must be useful to determine whether
8 a governmentally mandated subsidy is needed to encourage the commercial offering of
9 local service. The purpose of my testimony is to identify two characteristics of an
10 appropriate cost model that are necessary to satisfy this basic objective.

11

12 Q. What are the two characteristics that you recommend be part of an appropriate
13 cost study to determine whether "universal service subsidy" is necessary?

14

15 A. First, an appropriate universal service cost study should recognize that the network
16 facilities (principally the loop and the fixed costs of local switching) used to provide
17 local exchange service inherently provide other services as well (for instance, vertical
18 services, toll and access). The cost of these facilities, however, cannot be assigned
19 among these services in any economically meaningful way. Rather than pursue the
20 fool's errand of cost-assignment, I recommend instead a cost analysis which identifies
21 the full cost of the typical family of exchange services offered over these facilities. This

1 a service outage. There would be an alternative path.
2 a full size alternative path between those switches.
3 It's at least 100%. Sometimes there's more than 100%
4 redundancy for that capability.

5 Another thing that's unique about this
6 model is that it explicitly costs signaling
7 facilities. In the old days the signaling that went
8 on was carried with the call on the same facilities.
9 Now we've gone to what's called out-of-band signaling,
10 which is a separate set of transmission facilities
11 that connect the switches, and also some stand-alone
12 computers that both control traffic and have large
13 databases in them to allow certain features to be
14 provided.

15 This model again is unique in that it
16 starts with all the locations of those computers, all
17 those signaling locations from the Local Exchange
18 Routing Guide, sizes those appropriately, and connects
19 those with facilities. This is not an add-on from a
20 different model. This model does it.

21 And again with signaling, it's engineered
22 to provide at least 100% redundancy, so if there's a
23 fiber cut or an outage of facilities, there's always
24 an alternative path, and service is not discontinued.

25 Inputs to the model, there are several

1 categories. Again, as I described, there are tens of
2 thousands you can change, about 1,600 that you
3 probably might want to look at possible changes to.
4 Those are the ones that are in the pulldown menus.
5 They are highly specific to the geographic
6 characteristics and the demographic characteristics of
7 Florida, down to within each -- these census block
8 levels and the census block group level, the soil
9 types and the like, all that information that you need
10 at that level of disaggregation, all the demographic
11 information in order to accurately predict whether
12 people have a telephone at all or whether they
13 subscribe to two lines or ten. You need information
14 about those customers again at that very disaggregated
15 level. All of that information is here.

16 We look specifically -- a lot of
17 investments you see put into cost studies on what's
18 referred to as an EP&I basis, engineering, furnished,
19 and installed. What that means is, what's being
20 capitalized is not just the cost of buying the
21 equipment. It's the cost of designing a place for it
22 in the network and putting it into place. All those
23 costs are then capitalized and depreciated over the
24 life of the asset.

25 We look at Florida-specific labor costs.

1 the 1995 proceeding that widespread local competition was "imminent", the competitive
2 language is little different now than then. There is still no widespread local competition
3 in Florida and ILEC earnings continue to grow.

4
5 Of course, one reason for these phenomena will become obvious during this proceeding.
6 As explained below, the ILEC residential-monopoly is a profitable monopoly, even with
7 the relatively low rates for "dial-tone" local service being charged today. Thus
8 profitability arises because customers don't typically buy just dial-tone service without
9 also obtaining other services. The financial attractiveness of the residential customer is
10 decided by the family of services sold with local service, and an appropriate cost
11 analysis should recognize this basic fact.

12
13 Q. How does your testimony relate to the testimony of other competitive witnesses in
14 this proceeding?

15
16 A. Individual FCCA members (such as AT&T) are also sponsoring witnesses that address
17 the technical details of the HAI model as a means to estimate the forward-looking cost
18 of exchange facilities in Florida. The HAI model satisfies the criteria I recommend here
19 and, as a result, I endorse the Commission's adoption of that methodology.

20

1 **II. The Importance of Comprehensively Defining "Basic Local Service"**

2 **to Include All Relevant Services and Costs**

3
4 **Q. Please describe your understanding of the Commission's task in this proceeding.**

5
6 **A. In Section F.S. 364.025(4)(b), the Florida Legislature directed the Commission:**

7
8 To assist the Legislature in establishing a permanent universal service
9 mechanism, the commission ... shall determine ... the total forward-
10 looking cost, based upon the most recent commercially available
11 technology and equipment and generally accepted design and placement
12 principles, of providing basic local telecommunications service ...
13
14

15 Implicit in this assignment is the responsibility to define an economically valid cost
16 methodology and to report the results of its cost-study to the Legislature in a format that
17 would allow informed debate on the need for an external, governmentally-mandated
18 subsidy fund.

19
20 **Q. Is it possible for the Commission to conduct a cost study limited to "dial tone"**
21 **local service without implicating other services?**

22
23 **A. No. A large portion of the cost of facilities which provide local exchange service**
24 **(principally the loop and switch) do not provide *just* local exchange service. These *same***
25 **facilities also provide switched access service, vertical services and other intraLATA**

1 services as well. This engineering fact carries an important economic implication and
2 underlies an equally important business reality.

3

4 **Q. Please explain the economic implication of this observation.**

5

6 A. The economic implication is that it is impossible to determine the cost of basic "dial-
7 tone" local service -- a cost which would include the cost of the loop and fixed cost of
8 the switch -- without also including in that cost the functionality which underlies other
9 services as well. Even though these facilities are used to provide other services,
10 however, there is no economically correct method to attribute (allocate or assign, choose
11 any term) the cost of these facilities to individual services.

12

13 This simple fact creates a rather large dilemma. If the full cost of the loop and local
14 switch is included in the cost of dial-tone local service -- and this cost is then compared
15 solely to the price of basic dial-tone local service -- it is possible to incorrectly conclude
16 that a subsidy is needed even though the customer is highly profitable to serve.

17

18 For instance, assume the following set of facts: (1) the fixed cost of the loop and local
19 switch total \$20.00 per month, (2) the ILEC charges \$15.00/month for local service, and
20 typically sells the average customer \$10.00 of optional services that cost \$1.00 (given
21 the existence of the loop and switch). What conclusions can be drawn from this set of
22 facts?

1 The first conclusion is that the customer is profitable to serve. The customer spends
2 \$25.00 per month for a family of services that cost \$21.00 per month to produce. No
3 external subsidy is needed or appropriate since the consumer is an attractive customer
4 in its own right.

5
6 Unfortunately, this same set of facts can also be used to mistakenly assert that this same
7 customer needs to be subsidized. This incorrect conclusion is reached if the comparison
8 considers only the local dial-tone service (and price) paid by customer, yet includes the
9 full cost of the underlying loop and local switching facilities. Under this comparison,
10 the revenue (\$15.00) is less than the "cost" (\$20.00), implying that a \$5.00 subsidy is
11 now needed to serve a customer which, in fact, produces a \$4.00 profit.

12
13 **Q. How can the Commission assure that the Legislature is provided the information**
14 **to conduct the appropriate comparison?**

15
16 **A. The way to avoid such a result is to understand at the beginning of the cost exercise the**
17 **important linkage between the cost of underlying facilities and the family of services**
18 **they support. This linkage can be addressed in two possible ways, only one of which**
19 **I recommend.**

20
21 First, the Commission can conclude that these facilities are joint-use facilities and
22 attempt to allocate a portion of the cost of these facilities to each revenue-producing

1 service (such as vertical services). For example, with the set of facts assumed above,
2 the Commission can assign the \$20.00 loop/switch cost to dial-tone and vertical services
3 in proportion to the revenue received. I am not recommending this approach, however,
4 because of the inherently arbitrary nature of the allocation involved. Fortunately, there
5 is a better way.

6

7 Q. What is the Commission's second option?

8

9 A. The second approach is consistent with sound economics and costing principles. This
10 approach also begins by recognizing that by including the cost of the loop and local
11 switch, the cost study is unavoidably including facilities which provide other profitable
12 services. However, instead of attempting to allocate the cost of these facilities, the study
13 would simply include the *remaining* costs of the entire family of services. That is, the
14 Commission would estimate the total cost of the family of services made possible by the
15 loop and local switch. By taking this holistic approach, there is no need for an arbitrary
16 allocation of these costs. What is more, this approach sets the stage for the Legislature
17 to make a valid determination as to whether any external subsidy is needed because it
18 would allow the Legislature to compare the total cost and revenue (and thus profit) to
19 provide service to the typical residential customer.

20

1 Q. Is this recommendation also consistent with the "business reality" that you
2 reference^d earlier?

3

4 A. Yes. The revenues from optional calling and vertical services (and, if continued to be
5 priced above cost, switched access service as well) are only practically available to the
6 customer's local telephone company. Whether served by the entrant or incumbent, the
7 revenue potential of a customer is not determined *solely* by the revenue received from
8 the end-user for basic local exchange service. These carriers will also expect to receive
9 revenues from other services they provide the customer and from the access charges that
10 are imposed on other carriers.

11

12 In these early (i.e., they have not yet started) years of local competition, there is little
13 reason to conclude that competition will challenge the traditional pricing of exchange
14 services which recovers exchange costs in both the basic service rate and in the prices
15 of the other services that the typical customer will purchase. After all, the first goal
16 of a competitive entrant is to win customers. Entrants must convince local customers
17 they should change carriers and will likely offer services that are priced similarly to the
18 incumbent LEC.

19

20 The fundamental calculus determining a customer's profitability is the full cost of the
21 facilities that serve it and the total revenue from the family of services that it purchases.

1 Because this basic equation defines profitability, the same variables should figure
2 prominently in any calculation intended to determine the need for subsidy.

3
4 **Q. Is it an unusual commercial practice to price some services/products high, and
5 others low, when they are typically purchased as a family of services/products?**

6
7 **A. No. For instance, it is generally recognized that razor-handles are underpriced (indeed,
8 frequently distributed in promotions) with the expectation consumers will later purchase
9 more profitable razor blades. Cellular phones are also priced relatively low, with profits
10 earned as cellular users purchase more expensive air-time. Is wire-line phone service
11 so different?**

12
13 **Q. Have you analyzed the spending pattern of BellSouth's residential customers in
14 Florida?**

15
16 **A. Yes. BellSouth filed with the FCC a distribution of its residential local revenues for the
17 month of October, 1994. (Universal Service Fund Data Request, CC Docket 80-286,
18 Order released December 1, 1994). Local service revenues were defined to include flat
19 monthly charges, extended area service charges, local usage charges, local mileage and
20 zone charges, local information call charges, taxes, Federal and State subscriber line
21 charges, other mandatory surcharges and optional services such as touch tone, call
22 waiting, call forwarding, etc...**

1 To determine the percentage of BellSouth's residential customers who obtained services
2 other than dial-tone local exchange service, I compared this revenue distribution to a
3 typical monthly price for dial-tone service (\$10.65) plus the FCC's subscriber line
4 charge (\$3.50). Comparing this monthly cost to BellSouth's residential revenue
5 distribution indicates that roughly 91% of its residential customers purchase more than
6 simple dial-tone local exchange service.

7
8 This statistic is all the more remarkable considering that it understates the revenue
9 potential of the typical residential customer for three reasons. First, the revenue
10 distribution did not consider the access revenues received from the interLATA long
11 distance calls the average customer either makes or receives in a typical month. Second,
12 the revenue distribution did not consider intraLATA toll revenues (or, alternatively,
13 access revenues if the ILEC does not provide the intraLATA toll service). Third, the
14 revenue distribution included customers with only a partial month's service, further
15 understating the typical spending pattern.

16
17 **Q. Do you expect that the revenues from other services will become even more**
18 **important in the future?**

19
20 **A. Yes. For instance, local customers are also now potential customers for faster access to**
21 **Internet services using loop-enhancing technologies such as ADSL. ADSL allows the**
22 **customer's local loop to support very rapid data speeds, in addition to their basic local**

1 service. BellSouth is currently marketing this service for \$59.95 per month, or \$49.95
2 per month if the customer subscribes to its Complete Choice Plan (a \$28.00 per month
3 option). The point here is the obvious fallacy of concluding that a subsidy would be
4 needed for such a customer -- a customer which would provide guaranteed monthly
5 revenues of more than \$70.00 per month -- simply because BellSouth's "dial-tone" rate
6 may be less than the full monthly cost of the local loop.

7
8 As explained above, the "dial-tone" rate is only one component of a customer's revenue
9 potential. And it is reasonable to expect that both the incumbent and the entrant will
10 offer relatively low dial-tone rates to attract (or retain) subscribers. This pricing
11 strategy, however, should not provide an excuse for a governmental subsidy to serve
12 profitable customers.

13
14 Q. Is there historical support for your characterization that traditional dial-tone
15 pricing is a really a commercial strategy?

16
17 A. Yes. Although now portrayed as a "social" responsibility, the term "universal service"
18 was first embraced as a *commercial* goal -- to establish the Bell System as a monopoly
19 provider of phone service to as many customers as possible. As recounted by Theodore
20 Vail, the preeminent Chairman of the Bell System:

21 The Bell Company, from the commencement of the business, intended to
22 control the business. The intent is not only claimed by all who were
23 parties to the management at the time, but it is shown in every record of

1 every transaction in the course of business. *One system, one policy,*
2 *universal service* is branded on the business in the most distinct terms.

3
4 Notes of Theodore Vail, as cited in The
5 Telecommunications Industry, by Gerald
6 Brock, page 102. Emphasis in the original.
7
8
9

10 Although BellSouth frequently characterizes its prices as the result of regulation, this
11 perspective ignores its own role. As long ago as 1877, long before regulators entered
12 the scene, the price for a set of telephones was \$40.00 per year for a business customer
13 and \$20.00 per year for a residence. (See Brock, The Telecommunications Industry, page
14 92). It is a testament to the strength of the Bell monopoly that 100 years later a similar
15 differential continues to characterize its local exchange prices. The Bell System's
16 commercial self-interest established its pattern of local exchange pricing -- a pattern that
17 regulators may have continued, but they did not invent.
18

19 Q. What do you recommend?
20

21 A. I recommend that the Commission adopt in this proceeding a cost study that estimates
22 the forward-looking cost for the typical family of local services. The cost of this family
23 of services would include the cost of conventional dial-tone local exchange service (i.e.,
24 the fixed cost of the loop and local switch), plus the additional costs associated with a
25 typical spending pattern of optional calling, access service and vertical services. The
26 total cost of this typical arrangement can then be used to compare to the average price

1 for this family of services to determine whether any external subsidy is appropriate in
2 Florida.

3

4 Q. Does the Commission have the flexibility to provide the Legislature with the
5 information recommend?

6

7 A. Yes. The Commission has been directed to report to the Legislature the cost of
8 providing "basic local telecommunications service" (F.S. Chapter 364.025(4)(b)). One
9 of the issues in this proceeding is the appropriate definition of "basic local
10 telecommunications service". Although I am not a lawyer, I believe that there is
11 ambiguity in the Statute concerning the definition of the "basic local telecommunications
12 service" that is to be the object of this universal service cost-study.

13

14 This ambiguity arises because the Florida Statute first defines "basic local
15 telecommunications service" quite specifically in Section 364.02(2). However, the stated
16 purpose of the cost-study required by Section 364.025 is "[t]o assist the Legislature in
17 establishing a permanent universal service mechanism". Presumably, therefore, the
18 intent of Section 364.025 is to determine the cost of "universal service", a term the
19 Legislature defines quite openly as "... an evolving level of access to telecommunications
20 services..." (Chapter F.S. 364.025(1)).

21

1 This inconsistency can be read to provide the Commission discretion over defining the
2 precise object of the cost study here -- discretion which I recommend the Commission
3 use to conduct an economically valid cost analysis to establish the cost of the typical
4 *family* of services that comprise "basic local telecommunications service" as that term
5 is used in Chapter 364.025(4)(b).

6
7 Alternatively, if the Commission does not decide to report this "family cost" as the
8 *single* cost measure in its report to the Legislature, I recommend that the Commission
9 report *both* the "basic local family cost", along with whatever more limited basic service
10 definition it adopts. With this information, the Legislature can then judge both the
11 relative pricing of basic dial-tone local service *and* the relative profitability of the
12 average local residential customer, thereby making a more informed decision as to
13 whether any external subsidy is needed.

14 15 III. Universal Service and Network Element Pricing

16
17 **Q.** Has the Florida Legislature provided guidance concerning the type of cost
18 methodology that should be used to estimate the "universal service" cost?

19
20 **A.** Yes. The legislation effectively requires that the Commission determine the *forward-*
21 *looking, economic cost* of exchange facilities. Specifically, Chapter 364.025(4)(b)
22 requires that the Commission determine the forward-looking cost, based upon the

1 most recent commercially available technology and equipment and generally accepted
2 design and placement principles. Similarly, forward-looking costs should also be
3 used to establish the price that an ILEC would charge to provide these same facilities
4 to a competitor as a network element. As I explain below, it is important that these
5 standards be applied consistently. That is, the same cost analysis should ultimately
6 be used to determine universal service subsidy and to establish network element
7 prices, most importantly as part of a program to deaverage network element prices.
8

9 **Q. What would be the effect of calculating universal service subsidies and network**
10 **element prices from different cost studies?**

11
12 **A.** The principal effect would be a competitively distorted universal service mechanism.
13 Competitive neutrality requires that both the UNE-based entrant and the incumbent
14 receive the same effective subsidy (assuming that one is available). If entrants pay
15 network element prices based on one cost analysis, yet subsidies are calculated from
16 a different cost study, then there would be instances where the subsidy available to
17 the entrant would be either too large or too small.
18

19 **Q. Can you provide a simple example to illustrate this point?**

20
21 **A.** Yes. For instance, consider a wire center where the universal service cost is
22 estimated to be \$40.00. If the price of the network elements used by the entrant

1 were \$50.00 (because they were estimated from a different cost methodology or
2 averaged over a different area), however, then the subsidy *actually* needed by an
3 entrant would be \$10.00 per month more than the level implied by the USF cost-
4 study. Conversely, if the network element prices totalled only \$30.00, then the USF-
5 cost study would indicate a higher subsidy than would actually be needed.

6
7 **Q. Does the FCC have an expectation that states will calculate universal service**
8 **support and network element prices consistently from the same cost analysis?**

9
10 **A. Yes. In fact, one of the reasons that the FCC encouraged state-conducted cost studies**
11 **was that this process would permit coordination between the calculation of universal**
12 **service support and network element pricing:**

13
14 We [the FCC] also affirm that state-conducted cost studies have the
15 advantage of permitting states to coordinate the basis for pricing
16 unbundled network elements and determining universal service
17 support. This coordination can improve regulatory consistency and
18 avoid such marketplace distortions as unbundled network element cost
19 calculations unequal to universal service cost calculations for the
20 elements that provide supported services.

21
22 Federal Communications Commission,
23 Report and Order, Docket 96-45, Adopted
24 May 8, 1997, paragraph 247.
25
26

1 Q. Is it important that the geographic unit used to determine subsidy be the same
2 geographic unit used to define network element prices?

3

4 A. Yes. There must be a consistent policy regarding geographic averaging for both
5 network element pricing and universal service support. That is, whatever geographic
6 unit is used for one should also be used for the other.

7

8 Q. Please provide an example that illustrates why the same geographic zones should
9 be used for network element prices and universal service support.

10

11 A. Assume that Florida has only two exchanges/wire-centers: a "high-cost" exchange
12 (with a monthly cost of \$30.00) and a "low-cost" exchange (with a monthly cost of
13 \$10.00). For purposes of illustration, assume that a single network element price is
14 established for these two Florida exchanges. The relevant question is then how
15 should the universal service cost be aggregated?

16

17 In this example, the average cost for these two exchanges is \$20.00/month. If these
18 exchanges are averaged for network element pricing, then they should also be
19 averaged to determine universal service support. To do otherwise would provide the
20 entrant with too little support in the low-cost exchange (that is, the entrant's cost in
21 that exchange would be \$20.00/month, not \$10.00), and too much support in the
22 high-cost exchange (where the entrant's cost is \$20.00 and not \$30.00).

1 Q. Does this mean that the Commission should establish new network element
2 prices deaveraged for each wire center in Florida?

3

4 A. No, not necessarily. In a perfect world, the most efficient outcome might be to
5 establish separate network element prices for each exchange or wire center. In the
6 real world, however, practical considerations -- such as the administrative difficulty
7 from having separate rates for each and every wire center in Florida, even if they
8 have similar cost characteristics -- justify some averaging of like exchanges.
9 Whatever the level of geographic averaging is adopted, however, it should be used
10 for both universal service and network element pricing.

11

12 Q. How should this need to consistently define universal service costs and network
13 element prices affect the Commission's report to the Legislature here?

14

15 A. The Legislature has directed the Commission estimate the network cost using a basis
16 no greater than the wire center as the unit of estimation. This means that the starting
17 point for the analysis should be a unique estimate of the cost of the network facilities
18 used to provide universal service in each wire center in Florida.

19

20 This step, however, is only the beginning. I also recommend that the Commission
21 establish a preliminary grouping of wire centers into zones to deaverage network
22 element prices and report the average cost for each of these zones.

1 Finally, because network element prices are currently established on a statewide
2 average basis, I recommend that the Commission also report to the Legislature the
3 statewide cost of universal service.
4

5 **Q. Has the Commission previously expressed any reservation concerning using a**
6 **consistent methodology to calculate network element prices and universal service**
7 **support?**

8
9 **A. Yes.** On April 22, 1997, Chairman Julia Johnson wrote Reed Hundt (Chairman of
10 the Federal Communications Commission) expressing the view that different cost
11 studies should be used to establish network element prices than should be used for
12 universal service support. The basic rationale in the letter was that universal service
13 cost should reflect the cost of a "hypothetical" network, while network element prices
14 should be based on the cost of the incumbent's "existing" network..
15

16 Although this may have seemed a reasonable distinction at the time the letter was
17 drafted, I believe that the distinction it draws -- that is, the distinction between the
18 forward-looking cost of the existing and hypothetical network -- is overstated. The
19 most important criteria of an economic cost analysis are that it be *forward-looking*
20 and *least-cost*. These criteria -- and the generally accepted starting point that cost
21 proxy models should accept the ILEC's wire-center locations as fixed -- effectively
22 eliminate the modeling distinction referenced in Chairman Johnson's letter.

1 The criterion that the cost-study be forward-looking substantially reduces the
2 significance of the existing network architecture. It is only appropriate to estimate
3 the *forward-looking* costs of the *existing* network configuration if the existing
4 network configuration would be used in the future. In an industry with rapidly
5 changing technology, however, the existing network is not likely to be the cost-object
6 modeled to determine forward-looking costs. As a result, any forward-looking study
7 will model a "hypothetical" network simply because, by definition if nothing else, the
8 future has not yet occurred.

9
10 On the other hand -- and independent of any theoretical propriety -- in practice
11 universal service cost proxy models do not consider purely "hypothetical" networks.
12 The cost-proxy models with which I am familiar with (the HAI model sponsored by
13 competitive entrants and the INDETEC model typically sponsored by incumbents)
14 begin with the assumption that the location of switches (i.e., the wire center) is fixed.
15 This "fixed wire center" assumption means that the cost being estimated is the
16 forward-looking investment cost *relevant to a network with these wire centers*. There
17 is nothing hypothetical about studies which begin with the basic wire-center footprint
18 of the incumbent.

19
20 Together, these factors diminish the concern expressed in Chairman Johnson's letter
21 that universal service and network element prices should be derived from different
22 cost studies. The forward-looking criterion means that an appropriate network-

1 element study would evaluate more than the ILEC's existing network; while the
2 fixed-wire center assumption constrains a cost-proxy model to estimating the ILEC's
3 forward-looking cost and not some hypothetical network.
4

5 **Q. What do you recommend?**

6
7 **A.** I recommend that the Commission strive to consistently apply the same cost
8 methodology -- including its geographic application -- to determine the cost of
9 network facilities used to provide universal service and to establish network element
10 prices. The end-point of these processes should be a consistently defined universal
11 service subsidy system and deaveraged prices for network elements. Only the
12 consistent application of the same methodology will assure the creation of a
13 competitively neutral universal service mechanism.
14

15 The Commission should establish preliminary zones for network element prices and
16 report universal service costs to the Legislature for each zone. This information
17 could then be used by the Legislature to evaluate the need for a permanent universal
18 service system, and by the Commission to deaverage network element prices on a
19 going-forward basis. This approach is clearly preferable to the alternative of waiting
20 for the Legislature to establish a universal service system without this important
21 guidance, and then having to match network element prices to whatever geographic
22 system the Legislature adopts.

1 Q. Does this conclude your testimony?

2

3 A. Yes.

1 BY MR. MCGLOTHLIN (Continuing):

2 Q And Mr. Gillan, did you also prepare rebuttal
3 testimony?

4 A Yes.

5 Q Do you have any changes or additions to that
6 testimony?

7 A No.

8 Q And do you adopt that as your rebuttal today?

9 A Yes.

10 MR. MCGLOTHLIN: I ask that the rebuttal
11 testimony of Mr. Gillan, be inserted at this point.

12 CHAIRMAN JOHNSON: It will be so inserted.
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1 shield their revenues from competition and to guarantee their
2 profits.

3

4 • Second, the ILEC testimony underscores the importance of
5 calculating the economic cost of the "family" of local exchange
6 services (i.e., the basket of services typically provided by a local
7 carrier to its subscribers) in order to correctly determine whether
8 any external subsidy is appropriate or necessary.

9

10 • Third, the ILEC testimony provides additional support for the
11 critical need to develop universal service support and network
12 element prices using the same cost methodology and geographic
13 application.

14

15 **Q. Did the ILEC testimony confirm your concerns that they would use this**
16 **proceeding to seek a massive subsidy fund?**

17

18 **A. Yes. The GTE testimony provides particular insight in this regard. GTE takes the**
19 **remarkable position that even its own cost study -- a cost study which it is**
20 **otherwise sponsoring as accurate and reliable -- should not be used because it**
21 **does not justify a sufficient subsidy. GTE's position is that a universal service**
22 **fund should guarantee the excess revenues that it receives today, and that its cost**

1 study should be "adjusted" to produce this end result (Seaman, page 20, emphasis
2 added):

3
4 ... GTE believes that any explicit universal service fund or
5 mechanism must be sufficient to replace all of today's implicit
6 subsidies, and *the results of any cost model should be adjusted to*
7 *accommodate this goal.*

8
9 GTE's testimony exemplifies the corrupting influence of unjustified subsidization.
10 An unearned subsidy, once implemented, becomes a perpetual entitlement in the
11 eyes of its recipient. Even though the BCPM cost model (according to GTE)
12 indicates a subsidy of "only" \$366 million, GTE claims that it should actually be
13 provided a subsidy of \$487 million per year. Of course, every dollar of subsidy
14 provided GTE must first be collected from a consumer -- a consumer entitled to
15 a solid explanation for its contribution.

16
17 Q. What "logic" does GTE use to justify its claim that it is entitled to an annual
18 subsidy of nearly 1/2 billion dollars per year?

19
20 A. GTE's core argument is that because it *currently* overprices some of its services
21 by \$487 million dollars per year, it is entitled to these revenues in *perpetuity*
22 (Seaman, page 6). The point of a universal service fund, however, is not to
23 protect GTE's over-pricing (or profits), but rather to provide external support in
24 those limited instances where network costs are so high as to jeopardize network

1 subscription. GTE never explains, however, why such a massive subsidy is
2 needed to protect universal service in one of the more dense and prosperous parts
3 of the state. (As an aside, if GTE really required \$487 million in external subsidy
4 just to serve the Tampa/St. Petersburg area, one wonders why Bell Atlantic would
5 agree to its merger or how GTE could have seriously considered purchasing MCI).

6
7 **Q. Can you provide any statistics that place GTE's subsidy claim in perspective?**

8
9 **A. Yes.** Even before considering GTE's \$121 million "adjustment" to its cost
10 analysis, its threshold claim that it needs a "cost-justified" external subsidy of \$366
11 million is extraordinary in its own right. In 1997, GTE's total intrastate revenues
12 were roughly \$950 million per year (GTE Exhibit SAO-1). Thus, according to
13 GTE, it requires an external subsidy roughly equal to 40% to 50% of its intrastate
14 revenues.

15
16 Imagine the distorted incentives that would develop if nearly half the market's
17 revenues were controlled by a fund-administrator, instead of the individual
18 decisions of actual consumers. From a management perspective, the universal
19 service fund would become the make-it-or-break-it "customer" -- with GTE's (and
20 every other carrier's) resources devoted to fund-qualification, fund-analysis, fund-
21 litigation and (let's be honest) fund-manipulation. The fund GTE recommends

1 here seems a far cry from the position summarized in the Commission's 1996
2 legislative report (page 73):

3 GTE believes that the primary tool for ensuring reasonable rates in
4 a competitive market is the competitive market itself. A universal
5 service policy -- in conjunction with other policies and actions
6 regarding local exchange telephone competition -- should not
7 distort the effective operation of the market any more than is
8 necessary to carry out the public policy of maintaining universal
9 service at affordable rates in Florida.

10
11 **Q. Are there other summary-statistics which demonstrate the unreasonableness**
12 **of the ILEC position?**

13
14 **A. Yes. One measure of the reasonableness of the ILEC testimony is the extent to**
15 **which their policies target universal service support. Carefully targeting assistance**
16 **has been a key objective of universal service reform, as noted in the Commission's**
17 **1996 Report (page 38):**

18
19 Parties generally believe that support should be targeted to low
20 income households and to high cost areas.

21
22 We [the Commission] agree that targeted funding is an appropriate
23 means of providing support...

24
25 The GTE and BellSouth testimony provide data which can readily be used to
26 determine the "target efficiency" of their proposals (Sprint/United's data does not
27 easily permit this comparison). Remarkably, BellSouth and GTE claim that a

1 subsidy is needed for 100 percent of their residential lines (Seaman Exhibit MCS-
2 2, page 5; Martin Exhibit PFM-1). This subsidy claim stands in stark contrast to
3 the analysis provided by AT&T witness Guepe (pages 17-20) that shows that the
4 residential market is *profitable* for both of these ILECs.

5
6 **Q. How can the ILECs claim they need a subsidy to serve profitable customers?**

7
8 **A. The ILECs claim they deserve a subsidy if the local rate (including the SLC) does**
9 **not fully cover all local network costs, without regard to the other services a**
10 **customer purchases in connection with its local service. As I noted in my direct**
11 **testimony (page 13), however, such a "dial tone-only" spending pattern is rare.**
12 **The commercial attractiveness of a customer is decided by its total revenue**
13 **potential, and not just the revenues collected in the basic local rate.**

14
15 The only valid comparison to determine whether a legitimate subsidy need exists
16 is to compare the total cost to provide the typical package of local services
17 purchased by an average customer to the revenues from this package. So that the
18 legislature can reasonably evaluate whether an external fund is appropriate, I
19 recommend that the Commission calculate and report this family cost, even if it
20 also reports a "cost" of the "dial-tone only" option as well.

21

1 Q. In your opinion, do the ILECs actually believe that the entire residential
2 market requires subsidy?

3
4 A. No. Again, consider GTE's shifting positions on this issue. On the one hand,
5 GTE argues that the *entire* residential market in its territory requires support. Yet,
6 GTE has requested confidential treatment concerning the details of its analysis,
7 arguing:

8

9 These detailed, specific data would be useful for competitors in
10 discerning the size and composition of GTE's market on a
11 geographically disaggregated basis. The support information would
12 reveal to competitors GTE's costs of serving particular areas and
13 which areas would be most lucrative.

14

15 This request for confidential treatment exposes the absolute fallacy of GTE's
16 arguments. According to GTE, there are *no* lucrative areas (at least residential
17 areas) in its entire region -- *every* residential line requires a subsidy. Further, if
18 GTE's proposal were implemented, then the "lucrative" of each area would be
19 defined by the available subsidy, an amount (one would assume) that would never
20 be proprietary to GTE. GTE's confidentially request confirms that GTE's
21 management understands that its residential customers are profitable, even if its
22 subsidy proposal implies otherwise.

23

1 Q. Is there also support for your recommendation that network element prices
2 and universal service support (if any) should be developed consistently?

3

4 A. Yes. Although I disagree with the bulk of Mr. Seaman's testimony, we do agree
5 on one point: network element prices and universal service costs should be
6 developed consistently (Seaman, page 9). In addition, Sprint's testimony supports
7 the position in my direct testimony (Gillan, pages 22-24) that the "fixed wire
8 center" assumption renders irrelevant any theoretical distinction between a
9 universal-service and network-element cost study.

10

11 Q. Why is the "fixed wire center" assumption important to the question of
12 consistent universal-service and network-element cost studies?

13

14 A. The Commission (in a letter from Chairman Johnson to the FCC) had expressed
15 a view that a different cost study could be used to estimate the cost of universal
16 service than that used to establish network element prices. The basis for this
17 opinion was the view that a *universal-service* cost study should look at the cost of
18 a hypothetical entrant (i.e., an entrant with no facilities), while a *network-element*
19 cost study should consider the costs that would be incurred by the incumbent
20 (operating efficiently). Although this distinction may be theoretically accurate, it
21 is important to appreciate that both cost models sponsored in this proceeding are
22 constrained (by adopting the incumbent's wire center location) in a manner that

1 eliminates any meaningful difference. As a result, there is no valid theoretical
2 reason to use separate cost models to determine universal service support and
3 network element prices -- and, as explained in my direct testimony, there are
4 compelling economic, policy and pragmatic reasons why the same analysis should
5 be used.

6
7 **Q. How important is the "fixed wire center" assumption to the cost model and**
8 **its results?**

9
10 **A. The "fixed wire center" assumption is critical. Consider the basic logic explained**
11 **in the testimony of Sprint witness, Dr. Staihr (Staihr, page 10, emphasis in the**
12 **original):**

13
14 The cost of basic telephone service is primarily, and in rural areas,
15 almost completely, determined by the cost of the *loop*.

16
17 ***

18
19 The cost of the loop is determined primarily by two factors:
20 *distance and density*.

21
22 ***

23
24 Both of these, *distance and density*, in turn depend on where the
25 model assumes customers are located in relation to the central
26 office, and located in relation to each other.

27

1 Much of the debate in this proceeding concerns the first half of this basic
2 relationship (estimating the location of the customers). But equally important in
3 the analysis is the assumption defining the other end of the loop: the location of
4 the central office.

5
6 By adopting a methodology which accepts the *incumbent's* central office as the
7 terminal point of all loops, these "universal-service" cost models are structured to
8 calculate the *same* cost-object as a "network element" cost study: the forward-
9 looking cost of an efficient incumbent. (The observation that each model has the
10 same *goal*, however, does not diminish the importance of the larger issue -- i.e.,
11 which model estimates the cost most accurately).

12
13 The basic conclusion of my direct testimony remains. The cost of network
14 facilities used to determine universal service support (if any) should be the same
15 as the cost-based network element prices applicable to the facilities. The
16 Commission should establish geographic zones for each and report the cost results
17 accordingly. I note that the Commission has already established/approved
18 geographic zones for Sprint/United in the context of the MCI/Sprint
19 Interconnection Agreement. This framework can be used as the starting point for
20 determining universal service costs for each of the same areas.

21

1 Q. Does this conclude your rebuttal testimony?

2

3 A. Yes.

1 BY MR. MCGLOTHLIN (Continuing):

2 Q Mr. Gillan, have you prepared a summary of your
3 testimony?

4 A Yes, I have.

5 Q Please proceed.

6 A Thank you.

7 Good afternoon, commissioners. At the opening of
8 Mr. Wood's summary this morning, he pointed out that over
9 the next week you'll hear all the technical details of two
10 cost models that you can stand. You'll be glad to know
11 that at least for my testimony that process should not
12 begin this afternoon. My testimony does not address the
13 specifics of either BCPM or Hatfield. Instead, it looks to
14 what is the cost object that these models should be
15 modeling for the Commission to fulfill its obligation in
16 this proceeding?

17 Basically, this is an unusual proceeding. The
18 Commission is not asked to be a judge of a policy issue.
19 It is being asked to engage in fact finding and report
20 those results to the legislature. Part of that fact
21 finding -- or the principal goal of this fact finding is to
22 arrive at the cost of basic local service. That is the
23 cost object.

24 My testimony looks at that cost object and makes
25 a recommendation to you that really, whichever of the most

1 models you ultimately adopt, that that cost model satisfied
2 two characteristics in order for the legislature to be able
3 to take the results from this proceeding and make a valid
4 determination as to whether or not a universal fund is
5 necessary. The first characteristic is that the model
6 should look at the total cost of providing the entire
7 family of local exchange services, not just dial tone
8 service but also the other things that a typical
9 residential customer purchases in conjunction with that
10 dial tone arrangement. That would include access, vertical
11 services and expanded local calling. If the Commission
12 looks at that total to calculate the total cost of that
13 arrangement, then it will avoid the need to either allocate
14 the cost of the loop in the switch among a variety services
15 an exercise which really can't be done in any economically
16 rational way; or secondly, it will avoid the legislature
17 having to pretend that people buy this facility and that's
18 all they use it for. What makes a customer profitable
19 isn't just what they pay for dial tone service, it's what
20 they pay in total for all the things they buy, and that's
21 the comparison that the legislature should be looking at
22 when it decides whether or not to provide a subsidy or
23 not. It makes no sense for them to design a subsidy system
24 that provides subsidies for customers that are already
25 profitable to serve.

1 The second characteristic that my testimony
2 addresses is the need at the end of the day for the cost
3 model and the network element prices to be derived from the
4 same model and in using the same geographic application.
5 If we have a system where universal service subsidies are
6 calculated on a wire center by wire center basis, the
7 network element prices should also be calculated on a wire
8 center by wire center basis so that the subsidy and the
9 cost that an entrant pays accurately match up. To do it in
10 any other way, to have some other form of averaging would
11 mean that entrants who buy network elements would either be
12 qualifying for too much subsidy or too little subsidy, and
13 that has to be taken into consideration as well.

14 Either one of the cost models can be made to
15 comply with these two criteria. They either can be run to
16 include the cost of all the relevant services. They all
17 can produce results in a way that makes the geographic
18 comparison valid. Hatfield, or the HAI model in this
19 proceeding has been run to produce the correct result for
20 the entire family. If the Commission adopts the Hatfield
21 model, it has the correct results in front of it. If it
22 chooses BCPM, an outcome that I'm not recommending, then
23 that model would have to be adjusted. Thank you.

24 MR. MCGLOTHLIN: Mr. Gillan is available for
25 cross sub.

1 COMMISSIONER CLARK: May I ask one question? Mr.
2 Gillan, how do you respond to: By looking at the family of
3 services, you are continuing the subsidy from the vertical
4 services?

5 WITNESS GILLAN: I wouldn't characterize that as
6 a subsidy, because you are collecting it from the person --
7 the only person that can sell me vertical services as a
8 consumer is the carrier that I've chosen as my local
9 telephone company. I can't go choose BellSouth for my
10 local telephone company and get vertical services from MCI,
11 so I don't think it's proper to consider that as a subsidy
12 as long as I'm the consumer purchasing it.

13 It seems to me you've got two choices here. You
14 can look at this as a problem from the perspective of what
15 service subsidizes another service, and if you go down that
16 path, then I think you're going to ultimately run into the
17 problem of having to allocate the loop and the port cost
18 among these different services.

19 COMMISSIONER CLARK: Well, what is the --

20 WITNESS GILLAN: Alternatively, you just look at
21 it by the customer. What does the customer pay? I'm
22 sorry.

23 COMMISSIONER CLARK: But what is the universal
24 service fund designed to do? Is it designed to subsidize
25 people who can't pay or subsidize high cost areas?

1 WITNESS GILLAN: I think that the -- well --

2 COMMISSIONER CLARK: And doesn't the answer to
3 that drive whether or not you should look at family of
4 services?

5 WITNESS GILLAN: Let me take the questions in the
6 order you asked them.

7 COMMISSIONER CLARK: Okay.

8 WITNESS GILLAN: I'm not sure about the second
9 part of the question about as to whether it drives which
10 one you select. I think that universal services as being
11 discussed here is really driven to provide support to high
12 cost areas.

13 COMMISSIONER CLARK: Okay.

14 WITNESS GILLAN: Not individuals who need
15 assistance. You have other mechanisms being developed for
16 individuals that need help, like Lifeline service.
17 However, even when you decide to look at a high cost area,
18 I think you have to look to the cost of those facilities
19 against the total range of services they provide. For
20 instance, if you adopt the methodology that the local
21 telephone companies are advocating here, which really isn't
22 a methodology that you adopt, if the legislature were to
23 adopt this idea that you compare the total cost against the
24 revenue that they receive just from basic local service,
25 then for at least GTE and BellSouth, and I don't know if

1 the answer is true for Sprint because they didn't provide
2 the data in this format, but for GTE and BellSouth, then
3 every single residential line in Florida is high cost,
4 every single one, every customer in Tampa, every customer
5 in St. Pete, every customer in Orlando, every customer in
6 Miami, every single residential customer in the State of
7 Florida is high cost. Now how can that possibly be?

8 COMMISSIONER CLARK: Are you saying that
9 according to GTE?

10 WITNESS GILLAN: According to the comparison
11 their method -- the comparison that they would have you
12 perform of looking just at the local rate and comparing it
13 to the cost, the result is every single customer is high
14 cost.

15 COMMISSIONER CLARK: GTE's comparison?

16 WITNESS GILLAN: GTE's customers and BellSouth's
17 customers. And it may also be true of Sprint, but they
18 just didn't file their evidence in this proceeding in a way
19 that made the calculation easy to do; but certainly for
20 BellSouth and for GTE that would be the result.

21 COMMISSIONER CLARK: So why -- If you're looking
22 at where the high cost area is, is it appropriate to look
23 at revenues from vertical services?

24 WITNESS GILLAN: Because those will be the
25 revenues that decide whether or not you need to create a

1 subsidy to attract entry to those customers. I think I now
2 understand your question.

3 COMMISSIONER CLARK: Is universal service
4 designed to attract entry?

5 WITNESS GILLAN: I think it's designed to be
6 competitively neutral. You have a cost out there that
7 should be the same whether the incumbent sells it to the
8 customer or an entrant buys the network elements from the
9 incumbent to supply the customer. So the cost should be,
10 if everything is done correctly, the same for entrant
11 versus the incumbent. If you make it an attractive
12 proposition -- if you make it compensatory to the
13 incumbent, then it should become attractive for an
14 entrant.

15 The reverse is also true. If it's already
16 attractive, if somebody could actually find a way to
17 compete, or if it's already compensatory to the incumbent,
18 then it wouldn't seem to me to have a need for an external
19 subsidy, and that's really the calculation we are asking
20 you to make and provide the legislature, so that they can
21 look at the information and say, there are customers and
22 there are areas that are already profitable and we don't
23 need to create subsidies there, even -- wholly aside from
24 what is the current rate structure used to collect the
25 revenues that make it profitable, and perhaps there are

1 areas that are not profitable where a subsidy would be
2 appropriate.

3 COMMISSIONER CLARK: Sounds like you are saying
4 we look at if it's a high cost area and then we determine
5 whether -- even if it is a high cost area, if it's likely
6 that people that are going to be living there are able to
7 pay it and are going to be buying vertical services, there
8 is no reason to subsidize.

9 WITNESS GILLAN: That's -- Yes.

10 COMMISSIONER CLARK: Okay.

11 WITNESS GILLAN: But you don't need to create at
12 this point a subsidy where something is profitable. That's
13 that -- that's really what it boils down to. Now over
14 time, as this, you know, shakes out, you may need to come
15 back and revisit it; but for right now there doesn't appear
16 to us to be a reason to go further into the analysis than
17 that.

18 COMMISSIONER CLARK: Do you know if Vista-United
19 gets any high cost funds from the federal model or the
20 federal fund now? I know they -- I'm pretty sure that
21 they --

22 WITNESS GILLAN: I know many years ago I looked
23 at that question, and the answer is yes, but it's been a
24 decade, so I don't know today.

25 COMMISSIONER CLARK: Okay.

1 COMMISSIONER JACOBS: How would you respond to
2 the position that it was asserted that new entrants are
3 only going to come into an area such as you just described
4 to cherry pick the best customers?

5 WITNESS GILLAN: Well, as a theory, that's
6 probably true. In reality, what we find is that there is
7 no way to get into the residential market today. If, in
8 fact, entrants had a way to buy -- in an efficient manner
9 buy the network elements they need from the ILEC to provide
10 service and compete in the residential market, then we
11 would have -- then we would have a real-world experience to
12 answer that question. If, in fact -- You know, there are
13 two ways this is going to work out. It's going to be a lot
14 like the long distance industry where, yes, there are some
15 customers that are very good, and there are some customers
16 that are not so good, and there are even some customers
17 that bad, but when you compete in a mass-market
18 arrangement, you run advertisements, you take the good with
19 the bad; and, you know, over a very extended period of time
20 maybe you start playing with your rates to attract more of
21 the very good and discourage some of the bad. But that
22 takes a very extended period of time, and we don't really
23 know how many of those customers exist today; and more
24 importantly, we don't know how many of those customers
25 would exist in a competitive environment. I mean you'll

1 have a lot of statistics today about 40% of the people
2 don't buy any vertical services. Well, when they are
3 priced at \$8 a vertical service, that may be true. But in
4 a competitive market, as people try to win customers, then
5 I would expect to see more people buy more vertical
6 services and maybe even spend more on telephone service in
7 total once they have a broader array of choices.

8 I can't sit here and guarantee you that once you
9 see competition you won't see people go only to the best
10 and leave the worst behind. On the other hand, I don't
11 think any of the ILECs can tell you in truth that that's
12 what will happen. The only way we'll know is if the market
13 is opened; and, quite frankly, once the market is open and
14 if you have enough competition, then a lot of the issue of
15 how this price issue should work should be left up to the
16 market and not decided in this room.

17 COMMISSIONER JACOBS: Thank you.

18 CHAIRMAN JOHNSON: I guess, no other question
19 from the commissioners? Then, Mr. Gillan is -- does he
20 represent everybody on this side.

21 MR. MCGLOTHLIN: No, he is only here for the FCCA
22 today.

23 CHAIRMAN JOHNSON: Okay. Any questions,
24 Mr. Melson?

25 MR. MELSON: No.

1 CHAIRMAN JOHNSON: Mr. Hatch?

2 MR. HATCH: No questions.

3 MR. WAHLEN: No questions.

4 MR. POWELL: I have a few areas, Madam Chair, I
5 would like to ask the witness about.

6 CHAIRMAN JOHNSON: Okay. Is your mike on?

7 MR. POWELL: Pardon?

8 CHAIRMAN JOHNSON: Is it --

9 MR. POWELL: I think it's on.

10 CHAIRMAN JOHNSON: Okay.

11 MR. POWELL: I'll move a little closer. Is that
12 better?

13 CHAIRMAN JOHNSON: Uh-huh.

14 CROSS EXAMINATION

15 BY MR. POWELL:

16 Q Mr. Gillan, good afternoon. My name is Lewis
17 Powell. Forgive me, I can't remember whether you and I
18 have bumped into each other before in the last couple of
19 years, but if we have, it's nice to see you again.

20 I've got -- I represent GTE, and I have a couple
21 of matters I would like to ask you about. You are an
22 economist?

23 A Yes.

24 Q I take it from your direct testimony that you've
25 spent more or less the better part of the last decade

1 consulting and testifying as an expert witness on the
2 subject of economics with respect to this industry?

3 A Yes.

4 Q Would it be fair then for us to conclude that you
5 value the science of economics or the discipline of
6 economics as a tool for commissioners such as the Florida
7 Commission in dealing with the issues presented by the
8 Telecommunications Act?

9 A Generally, yes.

10 Q Is there anything about the science of economics
11 that you would not recommend to the Florida Commission as
12 it deals with these issues?

13 A Not that I can think of.

14 Q Let me ask you to focus your attention, please,
15 on existing retail prices for vertical features, access and
16 toll. Would you agree that those prices today are
17 substantially in excess of the underlying cost of those
18 services?

19 A The incremental cost, yes.

20 Q Would you also agree that a CLEC contemplating
21 entry into the local exchange has at least two choices: It
22 can enter through resale, or it can enter through leasing
23 unbundled network elements?

24 A In theory, yes.

25 Q And if the CLEC were to choose unbundled network

1 elements as the route of entry, it would be leasing those
2 elements at cost-based rates?

3 A That is the theory, yes.

4 Q It's correct, is it not, that this Commission has
5 established permanent UNE rates in Florida?

6 A Well, permanent for the life of a contract, yes.

7 Q Understood. And it's true, is it not, that those
8 are cost-based rates?

9 A I'll accept that.

10 Q Assume for me, if you will, the existence of 10
11 ILEC business customers which are targeted by a competitive
12 local exchange carrier entering the market and that that
13 entering CLEC decides that it wants to lure those 10
14 business customers away from the ILEC using the UNE method
15 of entry. Will you assume that with me?

16 A Yes.

17 Q If the CLEC is successful in doing that and lures
18 all 10 of these business customers away from the ILEC, at
19 the end of the day the ILEC's wholesale revenue from
20 leasing UNES to the CLEC will be substantially less than
21 the ILEC's aggregate retail revenue was before, would it
22 not?

23 A Yes, for those 10 customers.

24 Q Yes, sir.

25 Do you have your rebuttal testimony handy?

1 A Yes.

2 Q Could you turn, please, to Page 37

3 (Witness Complied)

4 A Yes.

5 Q Thank you.

6 Just a couple of clarifying questions here,
7 Mr. Gillan. You discuss GTE's testimony in particular with
8 reference to size of the fund that GTE believes would be
9 appropriate in Florida, do you not?

10 A Yes.

11 Q And, obviously, it goes without saying, you take
12 issue with GTE on that score?

13 A Yes.

14 Q You refer towards the bottom of that page to
15 overpricing by GTE and profits by GTE. Do I understand
16 your testimony to mean that in your opinion GTE is earning
17 an excessive rate of return in Florida?

18 A I didn't look at GTE's rate of return.

19 Q So then --

20 A The answer is no, not necessarily.

21 Q So you have not undertaken any empirical studies
22 in Florida?

23 A No, you are not rate-of-return regulated, so
24 there was no reason to.

25 Q Have you undertaken to examine GTE's

1 profitability in Florida?

2 A Broad scale in terms of looking at whether or not
3 residential customers in total are receiving a subsidy from
4 business customers.

5 Q And what is your conclusion with respect to that?

6 A That they are not.

7 Q In the aggregate, though, residential and
8 business in Florida, have you undertaken an analysis of
9 GTE's profitability?

10 A No, you are not rate-of-return regulated so I had
11 no reason to.

12 Q Let me direct your attention to the subject of
13 loop cost. In your direct testimony you have discussion of
14 loop cost, and would it be fair to say that the issue of
15 loop cost allocation is important to the Commission as it
16 undertakes to answer Issue Number 1 with respect to the
17 cost of basic local service?

18 A Yes. I mean there are parties recommending that
19 they allocate the loop cost among different services. I'm
20 not one of those parties, but there are people in the
21 proceeding that are recommending that, I believe.

22 Q Do I correctly understand your direct testimony
23 to be, and I think consistent with your summary earlier,
24 just a few minutes ago, that you urge the Commission
25 instead to look at, I think you call it the family of

1 services that are supported by the full functionality of
2 the loop and the switch and to identify the cost of that
3 family of services; is that correct?

4 A Yes, because at that level, there is a cost that
5 is actually defined. You know what the cost of the loop
6 is, you know what the cost of the switch is, and you know
7 what the services that they provide are; so at that level
8 of aggregation, you have a problem with actual definition
9 to it. When you get below that, then you start losing that
10 clarity and definition.

11 Q And is that where, if I understood your testimony
12 correctly, that you would consider it a "fool's errand," to
13 use your language, to try to actually allocate the cost of
14 the loop among the various services?

15 A Yes, that was one "fool's errand," and then the
16 alternative "fool's errand" is the one recommended by the
17 ILECs, that you pretend that it doesn't do anything except
18 provide local service or, you know, the dial tone component
19 of it.

20 Q And I understand your testimony also to be,
21 correct me if I'm wrong about this, that you see an
22 ambiguity in the Florida statute with respect to exactly
23 what basic local service is?

24 A In the context of the universal service section,
25 yes, I think there is a tension between the way the

1 universal service section is written, which refers to
2 universal service as being this evolving level of
3 telecommunications which would appear to indicate that
4 there is Commission discretion, and then in a different
5 section of the statute a definition of the term.

6 Q And that separate section would be 364.02(2),
7 would it not?

8 A Yes.

9 Q Assume with me for the sake of my next several
10 questions that the Commission, or the legislature for that
11 matter, were to determine that section 364.02(2), already
12 defines basic local service to be what you've considered --
13 or what you've characterized as dial tone service. Will
14 you make that assumption for me?

15 A If you would like, yes.

16 Q If that threshold decision is made, then it would
17 be necessary, would it not, for the Commission or the
18 legislature to decide how to allocate the cost of the
19 loop? In other words, to engage in what you call the
20 "fool's errand," that you would rather they not do, but
21 with this assumption they would have to do?

22 A I'm only hesitating because I'm not sure who
23 would have to engage in that process.

24 Q And I don't mean to be asking you whether it
25 would be the Commission on the one hand or the legislature

1 on the other, but some decision maker in Florida would have
2 to engage in that allocation, would it not?

3 A Yes, if it were to then be used in a formula like
4 that advocated by the ILECs. There might be some way to
5 use that information and not reach a perverse result, but
6 if you -- at least if you start with that definition and
7 then calculate a cost that includes the full cost of the
8 loop and the local switch and then use it to compare only
9 to dial tone rates, then somebody -- then you would have to
10 allocate in some way, yes, to avoid the equally perverse
11 result of concluding that you needed a massive universal
12 service fund to serve a class of customers that is already
13 profitable to serve.

14 Q Staying within the confines of the assumption
15 that we have been making here, that this inquiry takes on
16 special significance because the cost of the loop is so
17 great compared to other costs. It's a big-ticket item?

18 A Yes.

19 Q Have you read the rebuttal testimony submitted on
20 behalf of GTE by Doctor Carl Danner?

21 A No.

22 Q Were you here for Doctor Danner's presentation
23 last week in the workshops?

24 A No.

25 Q Will you accept --

1 A At least if I was, he wasn't very memorable.

2 Q Will you accept for the sake of my next couple of
3 questions, subject to check, that Doctor Danner takes a
4 rather different view than you do about the wisdom of
5 allocating the full cost of the loop to the cost of basic
6 local service?

7 A I will accept that. I'm not sure -- I'm worried
8 that you may not be correctly characterizing my position on
9 the allocation, but I will accept that, yes.

10 MR. MCGLOTHLIN: I'm going to object to any line
11 of questions that requires Mr. Gillan to answer questions
12 about testimony that he has already said he has not read,
13 that he is not aware. GTE has got the witness; that
14 witness can make his own case.

15 CHAIRMAN JOHNSON: Mr. Powell.

16 MR. POWELL: All I was asking is for the witness
17 to accept subject to check my characterization of Doctor
18 Danner's testimony. The testimony is what it is.

19 CHAIRMAN JOHNSON: I'll allow it.

20 BY MR. POWELL (Continuing):

21 Q What does the science of economics teach us about
22 how to allocate the cost of the loop?

23 A It teaches you that you can't. That's why you
24 shouldn't define the problem in such a way that you feel
25 the need to. There is no reason to define the problem that

1 way here. It would be wrong to define the problem that way
2 here, and that's why I haven't recommended that we proceed
3 in that way.

4 Q If, however, the Commission determines that it
5 needs to allocate the cost of the loop, what does the
6 science of economics teach on that subject?

7 A That you have complete elasticity in the choices
8 you make because all of them will be equally arbitrary, so
9 the Commission could allocate it in any way they want after
10 they've decided that that's the path they want to go
11 down.

12 Q Can you cite to the Commission any learned
13 treatise or article in the subject -- in the field of
14 economics that supports your testimony in this regard?

15 A Almost any economics text you would pick up would
16 tell you that you cannot correctly allocate this in an
17 economic fashion across different services that use it in
18 the way that the loop is used.

19 Q Can you identify a single such source?

20 A I wish I had read your economist's testimony
21 because, unless I'm mistaken, I believe that he would be
22 one such source. Certainly the testimony of Doctor Taylor
23 in this proceeding. I am not recommending that the
24 Commission allocate the loop. I am recommending that they
25 look at the problem at the level of the total cost of the

1 loop and the revenues of all the services that it provides
2 so that you don't have to engage in a debate that is
3 inherently uneconomic.

4 Q Mr. Gillan, other than your testimony here and
5 elsewhere, have you written on this subject?

6 MR. MCGLOTHLIN: Would you be specific as to the
7 subject you are inquiring about?

8 Q The subject of what the science of economics
9 teaches about proper allocation of the cost of the loop.

10 A Yes.

11 Q Where have you written on that?

12 A Testimony over the past 15 years.

13 Q Other than testimony --

14 A Early articles that I wrote when I was much
15 younger.

16 Q Could you cite a couple of those articles for our
17 benefit?

18 A I believe there is an article that appeared in a
19 magazine called Telematics. It was the national journal of
20 law and economics for the telecommunications industry. It
21 would have been probably ten years ago.

22 Q And it's your testimony that in that article you
23 discuss the economics of loop cost allocation?

24 A At least to the extent that I discussed that you
25 shouldn't allocate it, yes.

1 Q And I'm sorry, the name of that journal again?

2 A Telematics, T-e-l-e-m-a-t-i-c-s.

3 Q Can you recall any othe. publications by you on
4 this subject?

5 A Not sitting here off the top of my head, no.

6 Q Mr. Gillan, would you recognize Doctor Alfred
7 Kahn as an authoritative expert in the field of regulatory
8 economics?

9 A Yes.

10 Q Are you familiar with his recent book entitled
11 "Letting Go, Deregulating the Process of Deregulation"?

12 A No.

13 Q You've not seen this book?

14 A Correct.

15 Q I'm going to read to you a passage from Doctor
16 Kahn's book. It's at Page 71, and my question is very
17 simple do you agree or disagree, and the passage is
18 follows: Quote, consumers impose the cost of the loop on a
19 telephone company and on society by the act of subscribing
20 to telephone service. The causation principle, therefore,
21 requires the cost of providing the loop be fully
22 incorporated in the cost of that basic service, close
23 quote. Do you agree or disagree with that?

24 A I agree in part and disagree in part.

25 Q In what respect do you agree and in what respect

1 do you disagree?

2 A I agree that when you subscribe that's when you
3 cause the cost to be incurred. I believe that the best
4 process to decide how that cost is then recovered is by
5 different providers offering customers different packages
6 of fixed and variable rates and free optional services and
7 other things to try and win customers because, for the same
8 reason that I testified that there is no correct way to
9 recover that in an economic fashion, there is also no
10 preordained way that I or anyone else in this room can tell
11 you is the best way consumers want to pay for it. And once
12 you turn this process into a process of companies trying to
13 win consumers instead of ILEC monopolies trying to justify
14 particular rate structures, the better off we will be.

15 Q That's all the questions I have for you Mr.
16 Gillan.

17 MR. POWELL: Thank you.

18 MR. FONS: No questions.

19 MR. CARVER: No questions.

20 MR. COX: Just a couple of quick questions.

21 CROSS EXAMINATION

22 BY MR. COX:

23 Q Good afternoon, to you, Mr. Gillan. I'm Will Cox
24 on behalf of the Commission staff.

25 You talked with GTE's counsel about this, the

1 definition of basic local telecommunication service that
2 the Commission should use for this proceeding; am I
3 correct?

4 A Yes.

5 Q And you advocated a family of services approach
6 over what you characterize as a dial tone approach; is that
7 correct?

8 A Yes, where the question is determining whether or
9 not there should be a government subsidy created, collected
10 and distributed, that's the comparison, you should look, at
11 that level.

12 Q Okay. Have you testified in any other state
13 universal service proceedings?

14 A Yes.

15 Q Did you testify on the same subject?

16 A Yes.

17 Q Are you aware in any of those state proceedings
18 that they adopted an approach where they used a family of
19 services approach?

20 A Yes, the FCC did, the joint board did, the
21 Tennessee commission did. I can't recall --

22 COMMISSIONER GARCIA: I'm sorry, one second.
23 What were you asking? What was the question?

24 MR. COX: The question was were they discussing
25 the dial tone approach definition, or universal services

1 proceeding versus a family of services approach.

2 A Typically this issue is keyed up in the following
3 way: What costs should I compare to determine whether
4 subsidy is needed or not? So I'm interpreting your
5 question to be, have I testified in other proceedings that
6 the relevant comparison should include the revenues from
7 this total family. And the answer is, that's what the FCC
8 decided, that's what the joint board decided, that's what
9 the Tennessee commission decided. I believe that that's
10 what the Kentucky commission decided, but my memory is --
11 you know, there is an order out, and I guess I should say
12 it will speak for itself. I'm not aware of -- those, I
13 believe, are the only states where the commission has taken
14 action on this issue afterwards. It's still an open
15 question, my understanding, in North Carolina, still an
16 open question in Alabama.

17 BY MR. COX (Continuing):

18 Q And this --

19 A Those are the only -- those would be the states.
20 And the New York commission did the same thing, although I
21 was not in that proceeding.

22 Q In those states where they did side with your
23 approach, were those commissions engaged in the process of
24 selecting a cost proxy model?

25 A I'm sorry, I'm -- did you say in those states

1 where they did adopt this approach, were they engaged in
2 the cost proxy model debate?

3 Q Yes.

4 A Yes, I believe that's the case in each one of
5 those proceedings. With the -- Tennessee looked first at
6 what services they would consider and then looked at the
7 cost proxy model, but it was in an overall -- it was in an
8 overall, you know, an overall proceeding, just broken down
9 into a sequence like that.

10 New York, I don't know whether or not New York
11 was engaged in selecting a cost model or if they were just
12 looking at what services they should look at to determine
13 whether or not subsidy was needed.

14 Q Earlier today in Mr. Wood's presentation he
15 discussed some additional cost factors that were placed in
16 the HAI model. I think he mentioned intraLATA toll
17 services and access. Would those be services that you
18 would consider in the family of services that should be
19 considered?

20 A Yes, those services were added to bring the cost
21 model result consistent with this definition.

22 Q Okay. So is it your opinion that we, the
23 Commission, the Florida Public Service Commission would
24 have a sufficient record, an adequate record to address the
25 family of services based on what has been filed in this

1 proceeding?

2 A Yes.

3 MR. COX: Staff has no further questions.

4 CHAIRMAN JOHNSON: Any questions from the
5 commissioners?

6 COMMISSIONER DEASON: I have a question.

7 Mr. Gillan, I understand that you believe that
8 competition would be the best method of determining prices
9 for services, correct?

10 WITNESS GILLAN: Yes.

11 COMMISSIONER DEASON: Of course we are not there
12 yet. You also agree with that?

13 WITNESS GILLAN: That's correct.

14 COMMISSIONER DEASON: So it's incumbent upon, at
15 least for the time being, for someone to take a look at the
16 pricing structure to see if it's an impediment to the
17 development of competition. Do you agree with that?

18 WITNESS GILLAN: Yes.

19 COMMISSIONER DEASON: Okay. And I also understand
20 it's your position that it's really a futile exercise to
21 try to allocate costs when those costs provide an array of
22 services?

23 WITNESS GILLAN: Yes.

24 COMMISSIONER DEASON: And it's also your position
25 that when you consider that whole family of services,

1 residential service is not being subsidized, it stands on
2 its own?

3 WITNESS GILLAN: You can make that determination,
4 yes.

5 COMMISSIONER DEASON: But you would also agree
6 though that there are specific customers within that whole
7 group of customers that perhaps are not paying their way?

8 WITNESS GILLAN: Yes.

9 COMMISSIONER DEASON: All right. Then the
10 question comes, how do you price those services such that
11 it does not give perverse signals to competitors when they
12 come into the market? And what I mean by that, it appears
13 to me -- I understand that a competitor is going to
14 attempt to provide service to those customers with the
15 least cost and provide the greater amount of revenue and
16 that that is acceptable. That's fine. But the question
17 is, there are customers out there who perhaps do not
18 subscribe to a lot of high price services and that there is
19 the responsibility of incumbent companies to provide that
20 service as the carrier of last resort. Do you understand
21 where I'm -- what I'm asking?

22 WITNESS GILLAN: Yes.

23 COMMISSIONER DEASON: Okay.

24 WITNESS GILLAN: Because I think there are two
25 questions. One is sort of what is the process we use, and

1 then what is the end result. It could turn out that once
2 the market is really open to competition and there is a lot
3 of competitive activity that people who don't buy a lot of
4 things start falling off into a wayside and start facing
5 increases that you would feel would be inappropriate,
6 okay? I'm not -- I'm not buying into the hypothesis that
7 this is a necessarily result or and inevitable result, but
8 if that is the result that we start moving towards and you
9 don't want that to happen, then I think at that point it
10 makes sense to look at creating a stripped-down service
11 that is subsidized; but the minute a customer wants to move
12 away from that stripped-down basic arrangement, then he
13 falls out of the potentially subsidized class of
14 customers.

15 Now this is my own opinion to you, Commissioner.
16 It is not something that any of my clients are sponsoring.
17 It is not something that has been batted throughout the
18 industry because right now everybody is so focused into
19 this cost revenue comparison way of looking at it.

20 What you don't want to have happen is the GTE
21 example, okay? The GTE example is patently absurd. We are
22 sitting down there, Tampa/St. Petersburg -- this is not a
23 high-cost area to begin with -- and they are here before
24 you saying that they need somewhere between 370, and what
25 is it, 500 hundred million dollars a year in subsidy to

1 serve a residential customer class that is already
2 profitable to serve because they are looking at the total
3 cost against this one rate element.

4 Over time I expect consumers will buy more and
5 more things over that loop and that there will be actually
6 more and more revenue streams coming on. ADSL, is the
7 perfect example. BellSouth is today out there selling --
8 at least advertising ADSL. I have no idea if you could
9 actually buy it, but advertising ADSL service in a package
10 with local service that comes out to about 70 bucks a
11 month. So here is somebody who would be sitting there just
12 paying for the ADSL service and their basic -- and then
13 their basic rate \$70, plus whatever else they are spending
14 in toll and everything else, and yet under this formulation
15 of the problem that they are trying to insist that you use
16 and you report to the legislature, they would qualify for a
17 subsidy. That is absurd.

18 If at the end of the day it turns out that there
19 is a service that you need to subsidize or a class of
20 customers you want to subsidize, then I would recommend --
21 I would think at that point you are going to want to make
22 sure that what they buy makes it generally unattractive so
23 that only those people that really don't have a need for
24 vertical services or don't want to buy ADSL or don't want
25 to make a lot -- or don't make a lot of toll calls, sign up

1 for this, and this is the only thing that you subsidize.
2 But it sure isn't a reason to go into the marketplace and
3 subsidize every single customer out there, even once that
4 are, you know, this quote attractive market that the ILECs
5 are claiming people are about to jump on and take. It
6 makes no sense to design a fund like that.

7 COMMISSIONER DEASON: Do you envision that would
8 be part of universal service?

9 WITNESS GILLAN: You mean that type of service?

10 COMMISSIONER DEASON: It would be, the universal
11 service fund would be used to provide that subsidy?

12 WITNESS GILLAN: Of the narrow service in the
13 future?

14 COMMISSIONER DEASON: Yes.

15 WITNESS GILLAN: Yes, I think at some point in
16 the future that would make sense, but at this point I think
17 it would be premature to develop that or to establish --
18 And that isn't what the legislature is asked to do in this
19 go around anyway, but you asked me a question, so I have
20 offered you my opinion on it. I don't think anyone wants
21 to see those customers that have a very narrow need
22 disappear or even have those customers not be attractive to
23 other users. But right now, that's not the type of system
24 that the local telephone companies are talking about.

25 COMMISSIONER DEASON: Do you agree that this

1 Commission no longer sets the prices? It's a question of
2 whether there should be flexibility given to companies to
3 change their pricing structure, or how do you view that?

4 WITNESS GILLAN: Well, let me answer it this
5 way: You couldn't implement what I just recommended to you
6 under the current statutory framework; but on the other
7 hand, you couldn't implement any of this stuff under the
8 current statutory framework. No matter how you look at it
9 there is going to be some new statutory framework to
10 address this problem.

11 COMMISSIONER DEASON: And I'm talking in the
12 broader sense. In other words, even if we were the final
13 decision maker and everyone realizes we are not because we
14 are making recommendations to the legislature, but under
15 current law, even if we wanted to change the prices, we no
16 longer have the authority to do that, correct?

17 WITNESS GILLAN: That's correct.

18 COMMISSIONER DEASON: Okay.

19 COMMISSIONER GARCIA: Let's just expound on what
20 you thought -- Your suggestion is something that piqued my
21 curiosity, and I don't want to get you in trouble with your
22 clients; but tell me again what your suggestion was and how
23 you would structure that because it's something that has
24 occurred to me, and I just want to hear it from someone
25 else.

1 WITNESS GILLAN: Okay. As long as that caveat,
2 that none of my clients are recommending this overhangs the
3 conversation.

4 COMMISSIONER GARCIA: And there is no evidence,
5 and you haven't written any economic journals under this
6 topic.

7 WITNESS GILLAN: Yeah, but it's all on this
8 little transcript over here.

9 COMMISSIONER GARCIA: Exactly. You can deny it
10 once we finish.

11 WITNESS GILLAN: It seems to me that part of the
12 problem here is that you are overlapping a concern for a
13 certain, relatively small group of customers with the
14 desire by the ILECs to effectively rebalance all of their
15 rates.

16 One way of breaking that link is to establish a
17 service that would qualify for a subsidy that only a, that
18 would be -- I want to use the word inferior service, but I
19 don't really mean it that way, but I mean it would be a
20 basic service that you could not add other things to.

21 COMMISSIONER GARCIA: A POTS service?

22 WITNESS GILLAN: Yeah, your basic POTS service,
23 that you couldn't add these other things to. So the minute
24 that you as a consumer vote to have a better local exchange
25 service, you would vote yourself out of the subsidy pool,

1 okay? In effect, you would put yourself where you are at
2 today. You know, you would be spending the money that
3 you've already demonstrated to everyone in this room that
4 you are willing to spend each month, 50, 60 bucks a month.

5 COMMISSIONER GARCIA: What percentage do you
6 think of the customer class do you think would opt to get
7 that basic POTS service?

8 WITNESS GILLAN: Guessing, I would say it would
9 be half of what get it today just because consumers don't,
10 you know, normally select the most efficient, you know,
11 choice in something like this. So if you look at the -- if
12 you looked at it and you said, all right, what percentage
13 of the population actually obtains this today in a defacto
14 sense, they don't subscribe to other things, then probably
15 some smaller subset would vote in to that subsidized
16 arrangement.

17 There is a caveat here because one of the revenue
18 streams that you cannot deny the customer, because you are
19 going to have to give them the ability to make long
20 distance phone calls, so one of the revenue streams that I
21 don't think -- one of the revenue streams that would have
22 to be priced at cost for this to work would be access, so
23 that whether the person actually made more calls or didn't
24 make more calls, they weren't creating revenues that were
25 not considered in this calculation. But I think we are

1 going to get there anyway, hopefully, and so that shouldn't
2 be a complicating factor; but I do think that that is
3 probably a criteria.

4 Anyway, that was what I was thinking, is it would
5 give you a chance to break this linkage between -- what the
6 ILECs are really trying to do is rebalance all their rates
7 but wash the money through a universal service fund so that
8 not only are they rebalancing their rates, but somehow they
9 are getting all their competitors to help contribute to the
10 revenues to rebalance them. And, you know, in fact -- and
11 having something out there for this other group of people
12 who really do just want a very simple arrangement.

13 COMMISSIONER DEASON: Under the current
14 situation, the incumbent LECs do not have the ability
15 themselves to rebalance, that's what we are here for is to
16 look at this, and it's because the current -- the way the
17 current law is written. You agree with that?

18 WITNESS GILLAN: That's correct, yes.

19 COMMISSIONER DEASON: So a lot of this really
20 boils down to how much flexibility should the incumbent
21 LECs have to price their services.

22 WITNESS GILLAN: That's part of it, and on that
23 question, I come down with, first, you create the
24 conditions for competition. If the competition succeeds,
25 then flexibility is the way they rebalance rates. If

1 competition doesn't succeed, then we have another problem
2 that we need to go back and address.

3 COMMISSIONER DEASON: Okay. That is my next
4 question. Should the degree of flexibility given to the
5 incumbent LEC somehow be tied to the amount of competition
6 which develops in the local market?

7 WITNESS GILLAN: Yes.

8 COMMISSIONER DEASON: Do you have a
9 recommendation as to how that should be structured?

10 WITNESS GILLAN: It's easier to give you like the
11 perfect-world example than talk about all the gradations
12 between here to there. If, for instance, an ILEC -- let me
13 back up.

14 LCI made a proposal. It was in the context of
15 271, but forgetting the 271 aspect to it, of having ILECs
16 separate themselves into retail entities and network
17 entities so that the retail entity would have to buy the
18 things that it needs to provide service to customers using
19 the exact same operational systems, everything, exactly the
20 same as all the competitors, not separate, but equal, but
21 the same. If you created that kind of environment, then
22 that retail entity of the ILEC would be -- wouldn't seem to
23 me qualified for about -- for basically the same degree of
24 regulation, great flexibility, as any competitor, because
25 it would be participating in the marketplace in exactly the

1 same way as all the other competitors.

2 So at that end of the extreme, the answer is, if
3 you get them to the point where they participate in the
4 market like any other competitor, then you can give them
5 total flexibility; and I think you can get there very
6 rapidly, but it would take a structural solution. If they
7 stay, kind of mingled up together like they are today where
8 there is sort of some operational systems that competitors
9 can use, others don't work as well, certainly there is
10 questions of parity, then you have to start mix and match
11 this; and quite frankly, I don't -- I wouldn't even
12 encourage you to go down that path. I think you award to
13 an ILEC for full -- for creating a truly competitive should
14 be full flexibility, and that if they don't go to that
15 length, I'm not sure they deserve any flexibility. I don't
16 know how else you'd get them to a state where they actually
17 implement the systems you need for a fully competitive
18 environment.

19 COMMISSIONER DEASON: In the IXE market, AT&T is
20 the dominant carrier, was continued to be regulated, and
21 that regulation was diminished and more flexibility was
22 given to AT&T as the market developed. You don't see a
23 similar situation here?

24 WITNESS GILLAN: Not really. I think the
25 fundamental difference is that AT&T wasn't -- AT&T's

1 cooperation in making the market competitive wasn't
2 required after divestiture. We solved that problem when we
3 divested the local telephone companies, and from that point
4 forward, we didn't need AT&T's cooperation any more for the
5 market to become competitive, so I wouldn't -- AT&T
6 didn't need the -- you didn't need to hold the flexibility
7 out to AT&T as a carrot.

8 In addition, the changes that I'm suggesting here
9 I think would bring about competition pretty rapidly, so
10 trying to match it up, I don't think would be appropriate
11 either because you would in a sense almost be flash cut.
12 One day there is very little competition, and then in a
13 very short window as these systems get up and running and
14 they are participating in the market exactly like everybody
15 else, you should move to a pretty competitive market very
16 rapidly. So I don't see the reason for a transition, and
17 there certainly wasn't the carrot reason in the days of
18 AT&T.

19 CHAIRMAN JOHNSON: Redirect.

20 MR. McGLOTHLIN: Briefly, yes.

21 REDIRECT EXAMINATION

22 BY MR. McGLOTHLIN:

23 Q Mr. Gillan, Mr. Powell referred you to Page 3 of
24 your rebuttal testimony where you make the point that GTE's
25 core argument is that it currently over prices some of its

1 services and, therefore, it's entitled to revenues
2 inperpetuity. You told him that you weren't talking in
3 terms of having reviewed GTE's rate of return. If you did
4 not speak in terms of a rate of return or profitability, in
5 what sense were you using the terms "overpricing" and
6 "revenue entitlement" at that point in your testimony?

7 A I was only pointing out that GTE's own position
8 was this is how much extra money gets from these services,
9 and rather than proving that they need it for anything,
10 they just simply made the assertion that because we caught
11 this today we should be guaranteed it inperpetuity, you
12 should put it in your universal service fund and allow us
13 to charge our competitors; and so I was really pointing out
14 the absurdity of talking into a number like that,
15 particularly -- I mean I know you all get numbers thrown
16 at you all the time. Five hundred million is a lot of
17 money. Even in GTE dollars, it's a lot of money. The
18 Tampa market has only got about 950 million retail
19 revenues, so they were talking about asking for a universal
20 service fund that would be larger than the retail revenues
21 they would collect directly from customers.

22 Q Mr. Powell also posed to you a hypothetical
23 involving GTE losing 10 business customers and with the
24 result that its wholesale revenue through the leasing of
25 UNES was less than the retail revenue that it lost. Is

1 there anything in that example, that hypothetical example,
2 in your mind that justifies either the methodology GTE
3 proposes or the subsidy that it wants?

4 A No, it's actually the reverse because what the
5 numbers did show is that residential customers are
6 profitable. Well, if residential are already -- are
7 profitable to serve, then if they lost these 10 business
8 customers, it is true that GTE would have less money, or I
9 guess ultimately Bell Atlantic would get less money; but it
10 doesn't mean residential rates should go up because the
11 other side of the equation that he implied, but never
12 addressed, is that residential customers were already
13 profitable to serve. They were covering their cost so,
14 therefore, the extra money he was collecting from business
15 customers was just extra money; it didn't support
16 residential customers.

17 Q Last question. Mr. Powell asked you to assume
18 that the Commission or the legislature adopted the
19 definition of basic local service that you oppose in this
20 proceeding, and your response was you shouldn't define the
21 problem in a way that requires allocation. Would you
22 elaborate on what you meant when you said you shouldn't
23 define the problem a certain way?

24 A You shouldn't try and look just at one service
25 and yet all the costs when those costs are there making a

1 whole family of services possible.

2 MR. MCGLOTHLIN: That's all the redirect.

3 CHAIRMAN JOHNSON: Thank you, Mr. Gillan.

4 MR. HATCH: AT&T calls Richard Guepe.

5 Whereupon,

6 RICHARD T. GUEPE

7 was called as a witness on behalf of AT&T and, having been
8 duly sworn, testified as follows:

9 DIRECT EXAMINATION

10 BY MR. HATCH:

11 Q Could you state your name and address for the
12 record?

13 A My name is Richard Guepe. My address 1200
14 Peachtree Street, Atlanta, Georgia.

15 Q By whom are you employed and in what capacity?

16 A I am employed by AT&T as a district manager in
17 their law and government affairs organization.

18 Q Did you prepare and cause to be filed in this
19 proceeding direct testimony consisting of 21 pages?

20 A Yes, I did.

21 Q Do you have any changes or corrections to your
22 direct testimony?

23 A No, I do not.

24 Q If I asked you the same questions as are in your
25 direct testimony, would your answers be the same today?

1 A Yes, they would.

2 MR. HATCH: Just to be clear, Madam Chairman,
3 before I proceed, make sure that everybody has got the
4 revised version that was filed October the 6th, before we
5 get any further and cause any confusion.

6 Madam Chairman, could I have Mr. Guepe's
7 testimony inserted in the record as though read?

8 CHAIRMAN JOHNSON: It will be so inserted.

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BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY OF

RICHARD T. GUEPE

ON BEHALF OF

AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.

Docket No. 980696-TP

REVISED OCTOBER 6, 1998

DOCUMENT NUMBER-DATE

11046 OCT-78

FPSC-RECORDS REPORTING

1 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND TITLE.

2 A. My name is Richard Guepe and my business address is 1200 Peachtree Street, N.E.,
3 Atlanta, Georgia 30309. I am employed by AT&T as a District Manager in the Law
4 & Government Affairs organization.

5

6 Q. BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND
7 BUSINESS EXPERIENCE IN THE TELECOMMUNICATIONS INDUSTRY.

8 A. I received a Bachelor of Science Degree in Metallurgical Engineering in 1968 from
9 the University of Notre Dame in South Bend, Indiana. I received a Masters of
10 Business Administration Degree in 1973 from the University of Tennessee in
11 Knoxville, Tennessee. My telecommunications career began in 1973 with South
12 Central Bell Telephone Company in Maryville, Tennessee, as an outside plant
13 engineer. During my tenure with South Central Bell, I held various assignments in
14 outside plant engineering, buildings and real estate, investment separations and
15 division of revenues. At divestiture (1/1/84), I transferred to AT&T where I have
16 held numerous management positions in Atlanta, Georgia, and Basking Ridge, New
17 Jersey, with responsibilities for investment separations, analysis of access charges
18 and tariffs, training development, financial analysis and budgeting, strategic
19 planning, regulatory issues management, product implementation, strategic pricing,
20 and docket management.

21

22 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY STATE PUBLIC
23 SERVICE COMMISSIONS?

1 A. Yes, I have testified on behalf of AT&T in Alabama, Georgia, Mississippi, North
2 Carolina, South Carolina, and Tennessee on product implementation issues, pricing
3 issues, and policy issues.
4

5 Q. **WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

6 A. The purpose of my testimony, and the testimony of other AT&T witnesses, is to
7 recommend to the Florida Commission the adoption of the HAI 5.0a Model as the
8 forward looking cost proxy model for the determination of costs for a permanent
9 universal service mechanism, to present results of the HAI 5.0 Model, and to
10 recommend specific policies concerning the implementation of a permanent universal
11 service mechanism.
12

13 Q. **HOW WILL AT&T ADDRESS THE ISSUES IDENTIFIED BY THE**
14 **COMMISSION?**

15 A. In its July 2, 1998 Order, the Commission set forth a list of issues to be addressed by
16 the parties in this docket. These issues are:

- 17 • For universal service purposes, what is the definition of basic local
18 telecommunications service?
19 • What is the appropriate cost proxy model to determine the total forward-
20 looking cost of providing basic local telecommunications service?
21 • Should the total forward looking cost of basic local telecommunications
22 service be determined by a cost proxy model on a basis smaller than a wire
23 center?
24 • What are the appropriate input values to the cost proxy model?

- 1 . What local exchange companies must use the cost proxy model?
- 2 . What are the results of the cost proxy model for these companies?
- 3 . What approach should be employed to determine the cost of basic local
- 4 telecommunications service for LECs that serve fewer than 100,000 lines?

5

6 AT&T is presenting the direct testimony of four witnesses in this proceeding to
7 address these issues identified by the Commission. I will address policy issues
8 concerning the selection of the cost model, the definition of supported services, and
9 the establishment of a permanent universal service mechanism. AT&T witness Don
10 Wood addresses the development of the HAI Model, its inputs and the resulting costs
11 to provide local service. AT&T witness John Hirshleifer addresses cost of capital
12 inputs, and AT&T witness Mike Majoros addresses depreciation inputs.

13

14 **Q. A REASON FOR THIS DOCKET IS TO EXAMINE COSTS OF LOCAL**
15 **TELECOMMUNICATIONS SERVICE FOR THE PURPOSES OF**
16 **ESTABLISHING A PERMANENT UNIVERSAL SERVICE MECHANISM.**
17 **WHAT IS MEANT BY A UNIVERSAL SERVICE MECHANISM?**

18 **A.** A universal service mechanism is the process or system set up to maintain the
19 objectives of universal service after the local market becomes competitive. The main
20 objective of universal service is to provide access to quality telecommunications
21 services at affordable rates to all consumers. In other words, to promote connectivity
22 to the telephone network. Consumers in all areas, including low-income consumers
23 and those in rural and high cost areas, should have the access and rates that are
24 reasonably comparable to those available for similar services in urban areas. If

1 universal service subsidies are required, the Telecommunications Act requires that
2 they be explicit; moreover, they should be no greater than necessary to cover the
3 forward looking economic cost of the supported services, and should be funded and
4 available on a competitively neutral basis.

5

6 **Q. HOW WOULD A UNIVERSAL SERVICE MECHANISM WORK?**

7 **A.** The implementation of a universal service mechanism requires the determination of
8 several factors. These include the identification of: (1) services to be supported by
9 the universal service fund; (2) who should receive universal service support; (3) what
10 constitutes an "affordable" rate for supported services; (4) what revenues and costs
11 are appropriate in determining whether subsidies are required; and (5) the funding
12 mechanism.

13

14 The process to determine universal service subsidy requirements has two principle
15 components – what are the costs to serve customers and what are the revenues from
16 customers. In general, the cost is compared to revenues to determine subsidy
17 requirements. An integral part of this process is to determine the cost of providing
18 universal service in geographic areas throughout the state. The HAI Model, which is
19 reviewed in detail by AT&T witness Don Wood, determines the forward looking
20 economic cost for the provision of universal service for each wire center.

21

22 **Q. IN THE CONTEXT OF THE ESTABLISHMENT OF A PERMANENT**
23 **UNIVERSAL SERVICE MECHANISM IN FLORIDA, WHAT IS MEANT BY**
24 **BASIC LOCAL TELECOMMUNICATIONS SERVICE?**

1 A. Florida statute Section 364.025(4)(b) states "To assist the Legislature in establishing
2 a permanent universal service mechanism, the commission, by February 15, 1999,
3 shall determine and report to the President of the Senate and the Speaker of the
4 House of Representatives the total forward looking cost, based upon the most recent
5 commercially available technology and equipment and generally accepted design and
6 placement principles, of providing *basic local telecommunications service* on a basis
7 no greater than a wire center basis using a cost proxy model to be selected by the
8 commission after notice and opportunity for hearing." Florida statute Section 364.02
9 (2) states "Basic local telecommunications service means voice-grade, flat-rate
10 residential and flat-rate single-line business local exchange services which provide
11 dial tone, local usage necessary to place unlimited calls within a local exchange area,
12 dual tone multi-frequency dialing, and access to the following: emergency services
13 such as "911," all locally available interexchange companies, directory assistance,
14 operator services, relay services, and an alphabetical directory listing. For a local
15 exchange telecommunications company, such term shall include any extended area
16 service routes, and extended calling service in existence or ordered by the
17 commission on or before July 1, 1995."

18
19 Section 364.02 defines basic local telecommunications service in the context of
20 alternative regulation for local exchange carriers and it specifies the obligations of
21 incumbent local exchange carriers that choose alternative regulation.
22 In this context, basic local telecommunications service is defined as that minimal
23 service which carriers selecting alternative regulation must make available to
24 consumers in the state of Florida. However, for the purposes of determining the size

1 of a universal service subsidy, it is appropriate to include all forward-looking costs
2 incurred to provide this functionality (the loop and the switch) to consumers. In
3 other words, the full cost of the loop and switch to provide all services that can be
4 furnished to consumers should be included, which is the costing process included in
5 the HAI Model. Including all these costs further provides consistency when
6 comparing costs to revenues to determine subsidy needs as I discuss further later in
7 my testimony.

8
9 **Q. SHOULD A PERMANENT UNIVERSAL SERVICE MECHANISM INCLUDE**
10 **SUPPORT FOR BUSINESS SERVICES OR ADDITIONAL (SOMETIMES**
11 **LABELED SECOND) RESIDENTIAL LINES?**

12 **A.** No. The support for universal service should not include support for any business
13 line service and should be limited only to the first residential line. Generally,
14 business services are priced above costs and, in the interests of economic efficiency
15 and the burden such a business subsidy would place on other users, should not be
16 subsidized. Businesses have a means of recovering their telecommunications costs
17 through the prices they charge in the market. Multiple residential lines go beyond the
18 goal of universal service of ensuring that customers are connected to the network.
19 Households with incomes capable of sustaining multiple lines into the house or
20 subscribing to advanced technological services should not receive subsidies for
21 additional telephone lines. In some cases, there are economic substitutes for second
22 telephone lines, such as cable TV-based internet access, or mobile phones.
23 Subsidizing multiple telephone lines could cause customers to make uneconomic
24 purchase decisions and inhibit growth of additional technologies. Subsidizing

1 multiple residential lines and business lines increases the size of the fund
2 unnecessarily; it must be remembered that for every dollar of subsidy provided, a
3 dollar must be taken from a Florida consumer.

4 A Florida universal service fund should have as its objective to provide assistance to
5 those Florida consumers who require assistance to stay connected to the
6 telecommunications network.

7

8 **Q. WHAT COSTS ARE APPROPRIATE IN DETERMINING THE EXISTENCE**
9 **OF ANY SUBSIDY AND NEED FOR FUTURE SUBSIDY SUPPORT FROM**
10 **UNIVERSAL SERVICE?**

11 **A.** On the cost side of the equation, both for purposes of federal and state universal
12 service support mechanisms, costs used in any universal service mechanism should
13 be consistent with the pricing of Unbundled Network Elements ("UNEs") -- both the
14 methodology and the level of aggregation should be consistent. The FCC
15 encouraged states to use consistent methodologies for setting unbundled network
16 element prices and for determining universal service support levels. (FCC Report and
17 Order CC Docket No. 96-45, Par. 251).

18

19 **Q. WHY SHOULD UNIVERSAL SERVICE COST STUDIES BE CONSISTENT**
20 **WITH COST STUDIES FOR PERMANENT UNE PRICES?**

21 **A.** The cost basis of the network facilities used to serve the customer should be the same
22 whether it is the incumbent local exchange carrier serving the customer directly or it
23 is the competitive local exchange carrier leasing those same facilities (as network
24 elements). In either instance, the relevant standard should be the forward-looking.

1 significantly different BellSouth model. Moreover, there are substantial differences
2 in certain significant inputs used to set the rates this year as compared to the rates set
3 in the initial arbitration proceeding in Docket No. 960833-TP. The model that GTE
4 is anticipated to file in this proceeding, the Integrated Cost Model, appears to be
5 substantially different from the model used by the Commission to set the UNE rates
6 in the AT&T/GTE arbitration proceeding in Docket No. 960847-TP. The diversity
7 in the manner in which current UNE prices were set underscores the need for the
8 Commission to adopt a comprehensive consistent cost model independent of the
9 ILECs that can be used as the basis for both universal service and network element
10 costs.

11
12 **Q. ON WHAT GEOGRAPHIC BASIS SHOULD THE TOTAL FORWARD-
13 LOOKING COST OF UNIVERSAL SERVICE BE DETERMINED; E.G.
14 GRIDS, CBGS, WIRE CENTERS, ETC.?**

15 **A.** The total forward-looking cost of universal service should be determined on a wire
16 center basis. The HAI Model already provides cost estimates for universal service
17 and UNEs at the wire center level. This is consistent with the FCC which requires
18 that any USF cost study or model used to calculate the forward-looking economic
19 costs of providing universal service in rural, insular and high cost areas must
20 deaverage support calculations at least to the wire center level. (FCC Report and
21 Order CC Docket No. 96-45, Par. 250).

22

1 Q. SHOULD THE GEOGRAPHIC BASIS FOR DETERMINING THE
2 FORWARD-LOOKING COST OF UNIVERSAL SERVICE BE THE SAME
3 BASIS ON WHICH THE NEED FOR A SUBSIDY IS DETERMINED?

4 A. Not necessarily; as previously indicated, in the process to determine subsidy
5 requirements, the permanent universal service mechanism should use costs
6 aggregated at the same level that UNE costs are offered. The basis to determine
7 costs is a separate and distinct issue from the basis to determine any subsidy needs.
8 If unbundled network elements are priced on a statewide basis, then statewide costs
9 are appropriate to use for universal service purposes; if unbundled network elements
10 are deaveraged by density zone, then density zone costs are appropriate to use for
11 universal service purposes. The critical relationship is between the geographic area
12 used to determine the need for a subsidy and the geographic area at which UNE costs
13 are averaged. These must be the same. There is no such required relationship
14 between the geographic basis for determining the forward looking cost of service and
15 the geographic area used to determine the need for a subsidy.

16
17 Q. SHOULD ALL ILECS BE REQUIRED TO USE THE SAME COST MODEL?

18 A. Not at this time. All non-rural LECs, that is, BellSouth, GTE, United, and Centel,
19 should be required to use the same cost methodology. It may not be appropriate at
20 this time for small rural LECs to use the same cost model as the non-rural companies.
21 The FCC has determined, for interstate high cost fund purposes, rural LECs will not
22 be required to use a forward-looking cost methodology at least until January 1, 2001.
23 Florida statute Section 364.024(4)(c) permits the Commission to determine small
24 LECs costs based either on a cost proxy model or an embedded cost basis.

1 Q. SHOULD UNIVERSAL SERVICE COST STUDIES BE COMPANY
2 SPECIFIC OR GENERIC?

3 A. The cost studies should be representative of an efficient firm providing service in
4 specific geographic areas. The cost study model should be generic in order to be
5 appropriately independent of the incumbent LEC's embedded network and
6 operations. However, the input factors should be relevant to the geographic areas
7 being served.

8
9 Q. WHAT IS THE COST TO PROVIDE UNIVERSAL SERVICE IN FLORIDA?

10 A. The total forward looking cost to provide universal service for areas served by
11 BellSouth in Florida is \$694.9M, this equates to an average of \$ 15.43 per residence
12 line per month in the BellSouth serving area. The total cost to provide universal
13 service for areas served by GTE in Florida is \$260.1M, this equates to \$ 15.37 per
14 residence line per month. The total cost to provide universal service for areas served
15 by United in Florida is \$223.5M, this equates to \$ 19.08 per residence line per
16 month. The total cost to provide universal service for areas served by Centel in
17 Florida is \$70.4, which equates to \$ 26.87 per residence line per month. The
18 underlying data for these costs is presented in the testimony of AT&T witness Don
19 Wood.

20
21 Q. PLEASE DISCUSS YOUR RATIONALE FOR WHAT REVENUES AND
22 COSTS SHOULD BE INCLUDED IN THE ANALYSIS OF BASIC LOCAL
23 RESIDENTIAL EXCHANGE SERVICE FOR THE PURPOSE OF
24 ESTABLISHING A PERMANENT UNIVERSAL SERVICE MECHANISM?

1 A. The costs used in the provision of local residential service should be the forward
2 looking economic costs associated with all services that utilize the local loop, which
3 are the dial tone related elements, state and interstate access services, and
4 discretionary service arrangements. The costs should be examined at the wire center
5 level. The revenues that should be included in the analysis of local residential
6 service are the same elements for which cost data is developed. These revenues, as
7 recommended by the Federal-State Joint Board on Universal Service, should include
8 local, discretionary, access services and other appropriate revenues, such as, yellow
9 pages¹. These are the revenues any company serving an individual residential
10 customer would anticipate to receive to offset the cost of serving that customer. For
11 purposes of federal universal service high cost support, the benchmark revenue per-
12 line will be a nationwide average of revenues derived from local services (including
13 revenues from discretionary services), and interstate and intrastate access. This
14 would equate to the per-line revenue that is paid to the local exchange carrier by the
15 end-user for services included in the local exchange market and by the interexchange
16 carriers for services included in the local exchange access market. The determination
17 of a subsidy is based on these revenues and the cost of serving customers. It is not
18 merely the revenues associated with basic local service, but all the revenues
19 associated with customers that both the incumbent and new entrant carriers evaluate
20 when analyzing the desirability of serving a particular market area. The revenue
21 benchmark basically sets the standard of a reasonable revenue level that a carrier
22 should expect to receive from its customers before it is able to draw from a subsidy
23 fund. Subsidy requirements should be determined by the elementary rule that
24 subsidy is only needed where the revenues expected to be received from customers

1 are inadequate to cover costs. The amount of subsidy required in each ILEC's area
2 would then be determined by comparing the geographic specific costs to the
3 associated revenues. In geographic areas where costs exceed revenues a subsidy
4 would be provided.

5

6 **Q. HOW SHOULD THE REVENUE BENCHMARK BE DETERMINED?**

7 **A.** The revenue benchmark should include all revenues that a local telecommunications
8 carrier can expect to receive, in addition to local service, from the discretionary
9 services and intrastate and interstate switched access services that are associated with
10 the provision of local exchange service. This is the same method to calculate the
11 revenue benchmark that the FCC used (and the Federal/State Joint Board
12 recommended) in determining the interstate benchmark.

13 The FCC explained the make-up of its revenue benchmark: "As the Joint Board
14 recommended, the revenue benchmark should take account not only of the retail
15 price currently charged for local service, but also of other revenues the carrier
16 receives as a result of providing service, including vertical service revenue and
17 interstate and intrastate access revenues. Failure to include all revenues received by
18 the carrier could result in substantial overpayment to the carrier." (FCC Report and
19 Order CC Docket No. 96-45, Par. 200)

20

21 **Q. WHY SHOULD THIS APPROACH TO CALCULATING THE REVENUE**
22 **BENCHMARK BE ADOPTED?**

23 **A.** This methodology is the only approach which really makes sense. The revenue
24 potential of a customer is not determined solely by revenue from basic local

1 exchange service. Carriers will expect to receive revenues from other services they
2 provide their customers, as well as revenues from access charges imposed on other
3 carriers when customers make toll calls. Moreover, customers do not subscribe to
4 telephone service simply to make and receive local calls. Telecommunications
5 service providers do not seek customers based solely on expected revenues from
6 basic local exchange service. It is the entire basket of services associated with each
7 customer's line in each wire center (i.e., the loop and the switch) that is important to
8 determine profitability and the need for a universal service subsidy. This is
9 particularly true in the context of the "one-stop shopping" environment expected in
10 the future. Carriers which control the loop and switch will endeavor to become the
11 provider of all services made possible by these facilities and will compete to attract
12 customers with a variety of pricing strategies. Competition will determine how
13 carriers recover the cost of the loop and switch across the basket of retail services
14 made possible by the loop and switch.

15
16 Additionally, the facilities which provide local exchange service do not provide just
17 local exchange service. The facilities that provide basic local service also provide
18 vertical services, switched access service, and other intraLATA services. Thus, a
19 customer cannot get local service from one provider and vertical services from
20 another. Likewise, a customer cannot order basic local exchange service without
21 also receiving the capability of receiving vertical services and access. Discretionary
22 services, access as well as basic local exchange service are all inherent, inseparable
23 capabilities of the loops and switches which serve customers in Florida. Because the

1 full cost of the loop and switch are included in the cost of universal service, all of the
2 revenues associated with these facilities should be included in the benchmark.

3

4 **Q. WHAT ARE THE CONSEQUENCES IF THE REVENUES FROM THESE**
5 **ASSOCIATED SERVICES WERE IGNORED?**

6 **A.** If all the revenues associated with the provision of local exchange service (and the
7 local loop and switch facilities) were not included in the revenue benchmark, then the
8 universal service fund would be sized too large because it would provide subsidies
9 where profits already provide incentives to serve. An inflated universal fund harms
10 consumers.

11 For example, an inflated universal service fund would mean that consumers would
12 face prices for telecommunications services that are too high. Consumers, through
13 the prices paid for all telecommunications services, ultimately fund universal service.
14 An inflated universal service fund unnecessarily takes too much from some to give it
15 to others. After all, universal service funding is a form of taxation and, like all
16 taxation, its administrators should be as judicious as possible in determining need
17 before imposing the tax.

18

19 Furthermore, the entire point of the federal Telecommunications Act of 1996 is to
20 provide consumers choice with the intention that competition will drive overall
21 telecommunications prices down. The universal service fund is an exception to this
22 process because universal service subsidies are a protected revenue source not
23 subject to competitive forces. Because competitive forces can never "compete

1 down" the size of a universal service fund made too large, Care must be taken in the
2 original formulation of a fund.

3

4 **Q. HAVE YOU ESTIMATED A PER LINE "REVENUE BENCHMARK" FOR**
5 **THE LARGE ILEC'S RESIDENTIAL CUSTOMERS IN FLORIDA?**

6 **A.** I have calculated an estimate of the "revenue benchmark" for residential lines in
7 BellSouth, GTE, United and Centel serving areas in Florida; however, the data to
8 calculate a precise revenue benchmark is controlled by the ILECs and is not publicly
9 available. In response to an FCC data request, the ILECs provided data which shows
10 that the average residential revenue for the basket of local services (not including
11 intraLATA toll or access revenues) in June, 1996. To complete the calculation of the
12 residential revenue benchmark requires adding to these amounts average residential
13 interstate access revenue and intrastate access revenue.

14

15 **Q. DO YOU HAVE THE DATA NECESSARY TO CALCULATE THE**
16 **AVERAGE ACCESS REVENUES SPECIFIC TO EACH ILEC'S**
17 **RESIDENTIAL CUSTOMERS?**

18 **A.** No. I am not aware of any publicly available access revenue information that is
19 specific to residential customers. The benchmark I have estimated relies on the
20 statewide (i.e., business and residential) average access revenue. The benchmark
21 calculation is summarized in Table 1 below:

22

Table 1: The Florida Residential Revenue Benchmark per Line

Revenue Category Line	Average Residential Revenue per Line		
	BellSouth	GTE	United/Centel
Local Service Revenue (with SLC)	\$ 18.90	\$ 11.56	\$ 24.98
IntraLATA Toll Revenue	\$ 1.07	\$ 4.92	\$ 2.06
Interstate Access Revenue (not SLC) ²	\$ 6.99	\$ 8.09	\$ 6.19
Intrastate Access Revenue ³	\$ 2.81	\$ 6.34	\$ 8.09
Directory	\$ 0.34	\$ 4.56	\$ 2.14
Total	\$30.12	\$35.47	\$43.47

The above analysis provides a reasonably reliable estimate of the residential revenue benchmark. However, the data for the precise revenue benchmark is controlled by the ILECs. In addition, the expected intrastate access revenues should be recomputed to reflect the implementation of cost based access charges. Table 2 estimates the revenue benchmark with cost based intrastate access charges.

Table 2: The Florida Residential Revenue Benchmark per Line with Cost Based Intrastate Access

	BellSouth	GTE	United/Centel
Average Residential Revenue per Line	\$ 27.17	\$ 29.37	\$ 35.64

Q. HOW WOULD AN ANALYSIS TO DETERMINE WHETHER RESIDENTIAL CUSTOMERS IN FLORIDA REQUIRE AN EXTERNAL SUBSIDY BE DONE?

A. There are two ways to analyze whether residential customers in Florida are subsidized overall. One method is to compare the cost per line with the revenue benchmark (with access priced at cost) for residence lines in each wire center. The total revenue shortfall (costs exceed revenues) or revenue surplus (revenues exceed costs) for each wire center is determined by multiplying the difference between the

1 costs per residence line and the residential revenue benchmark by the number of
2 residence lines in the wire center. The sum of shortfalls (subsidies) and surpluses for
3 each wire center served by the local exchange company equals the total subsidy
4 needs, state and interstate, for the company. It is appropriate to sum not merely the
5 subsidies for each wire center, but both the revenue shortfalls (wire centers where
6 costs exceed revenues) and the revenue surpluses (wire centers where revenues
7 exceed costs) across all wire centers to determine the overall subsidy requirement.
8 Until competition drives prices toward costs in these exchanges where a surplus
9 exists and cost based unbundled network elements are not only deaveraged but easily
10 available for use, it is appropriate to determine the total subsidy by netting the
11 revenue and cost differences across all wire centers. It is not appropriate to look only
12 at the wire centers that have a negative contribution (costs exceed revenues) and
13 ignore the revenues from those wire centers that have a positive contribution. All
14 relevant revenues with each ILECs serving areas should be taken into account.
15 The netting process is equivalent to the second analysis method which is to compare
16 the ILEC's total residential revenues (with intrastate access priced at cost) to the
17 aggregate residential cost calculated by the HAI Model. This comparison of
18 residential revenues and aggregate residential costs is summarized in Table 3 below.
19 The aggregate residential revenues were calculated based on the number of
20 residential lines in Florida from the HAI model and the revenue benchmark per line.

21
22
23
24

**Table 3: Comparison of Residential Revenues and Costs
(\$ millions/year)**

	BellSouth	GTE	United	Centel
Estimated Residential Revenues	\$ 1,223.7	\$ 497.1	\$ 417.5	\$ 93.4
Estimated Residential Costs				
HAI Model	\$ 694.9	\$ 260.1	\$ 223.5	\$ 70.4

Table 3 shows that the revenues received from residential customers far exceed the cost to serve these customers.

11 **Q. WHAT SHOULD BE THE AMOUNT OF SUPPORT IN A FLORIDA
12 UNIVERSAL SERVICE SUPPORT SYSTEM?**

13 **A.** Current revenues for BellSouth, GTE, United and Centel local residential and
14 associated services exceed the costs of providing those services. Consequently,
15 Florida does not now require an intrastate universal service fund.

17 **Q. IS THIS RESULT CONSISTENT WITH THE TELECOMMUNICATIONS
18 ACT OF 1996?**

19 **A.** Yes it is. The Telecommunications Act of 1996 directs the Federal Communications
20 Commission to set up procedures for a federal universal service fund and it allows
21 states to set up a fund if the states determine it is necessary.

23 **Q. WHAT ACTIONS DO YOU RECOMMEND TO THE FLORIDA
24 COMMISSION?**

25 **A.** I recommend that the Commission 1) adopt the HAI Model to determine the forward
26 looking economic cost to provide universal service and report these costs to the

1 legislature, 2) recommend to the legislature that the universal service mechanism
2 process analyze the potential need for any explicit subsidy by comparing the
3 incumbent LEC's statewide residential revenues to the statewide cost to serve
4 residential customers (a statewide calculation is the most appropriate basis to
5 determine whether an intrastate universal service fund is necessary because
6 competitive conditions for residential customers are reasonably uniform across the
7 state today, and in an environment of statewide average network element prices --
8 and OSS systems which are incapable of supporting mass-market residential
9 competition even if network element prices were deaveraged -- there is no reason to
10 analyze the need for subsidy at a more granular level until competition develops and
11 unbundled network elements are deaveraged), and 3) recommend to the legislature
12 that only single line residential lines be eligible for support.

13

14 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

15 A. Yes.

1 Historically, Yellow Pages have provided support for universal service, and, in fact, Judge Green decided that these would remain with the Bell Operating Companies at divestiture because the revenue from this source was used to support universal service.

2 Source: BellSouth, GTE, Sprint 1997 ARMIS Reports 43-01; and BellSouth 1997 ARMIS 43-04, GTE 1996 ARMIS 43-04, Sprint 1995 ARMIS 43-04.

3 ILEC ARMIS data reports total intrastate access revenue without separately identifying the switched and special access categories. To remove an estimate of intrastate special access, the intrastate total access revenue was reduced by the same proportion that interstate special access is to interstate total access. Because most special access is interstate, this adjustment is likely to result in an understated estimate of intrastate switched access per line and thus produces a revenue benchmark which is too low.

1 BY MR. HATCH (Continuing):

2 Q Mr. Guepe, do you have a summary of your
3 testimony?

4 A Yes, I do.

5 Q Could you please give that?

6 A All right. Good afternoon, Commissioners. In my
7 direct testimony, I recommend the adoption of the HAI model
8 to determine universal service costs, and I address the
9 policy issues surrounding the selection of the cost proxy
10 model which is required by the Florida legislature to
11 assist in its establishment of a permanent universal
12 service mechanism.

13 Other AT&T witnesses will address the cost proxy
14 model and the appropriate inputs that should be used to
15 determine universal service cost. Specifically, Mr. Don
16 Wood addresses the development of the HAI model and its
17 outputs. AT&T witnesses John Hirschleifer and Mike Majoros,
18 whose testimonies were stipulated, addressed the cost
19 capital and depreciation inputs respectively.

20 Shortcomings for the BCPM are addressed by
21 Mr. Brian Pitkin, and Mr. Wood, Mr. Art Lerma and
22 Ms. Catherine Petzinger. As you consider the appropriate
23 cost model to use, it is important to remain aware of major
24 factors that influence the process to determine and
25 implement, if needed, a permanent universal mechanism --

1 universal service mechanism. Examples of these are the
2 relationship of unbundled network element costs and
3 universal service cost, the granularity of the cost study,
4 which companies should use the cost proxy model, what
5 revenues as well as costs are appropriate in determining
6 any subsidy requirements, and the actual funding
7 mechanism. All of these issues are relevant to the
8 establishment of a permanent universal service mechanism.
9 The actual process to determine universal service subsidy
10 requirements really has two principal components: What are
11 the costs to serve customers; and what are the revenues
12 from customers?

13 In general, the cost is compared to revenues to
14 determine subsidy requirements. The cost portion of this
15 process is an important part of this hearing. How do you
16 determine the cost of providing universal service in
17 geographic areas throughout this state? AT&T recommends
18 the cost model develop universal service cost on a wire
19 center basis. AT&T has performed its cost studies using
20 the HAI model on such a basis. This is consistent with
21 both Florida and FCC requirements; however, this Commission
22 when reporting the results of its investigation of
23 universal service costs to the legislature, should note
24 that when a determination of universal service support is
25 made, given existing market conditions, these costs should

1 be aggregated to company-wide costs for residential lines
2 served.

3 These costs would then be compared to a
4 company-wide average revenue per residential line. I
5 recommend this for the following reasons: First, this is
6 consistent with the level of deaveraging of unbundled local
7 loops that this Commission has approved; and second, due to
8 the lack of a competitive local exchange marketplace in
9 Florida, there is no need to look further than the
10 company-wide data for the determination of need.

11 It is important to recognize, as the FCC
12 encouraged the states, that costs used in a universal
13 service mechanism should be consistent with the pricing of
14 unbundled network elements. Both the methodology and the
15 level of aggregation should be consistent.

16 Now why should this be a requirement? It is
17 necessary because the cost basis of the network facilities
18 used to serve the customer should be the same whether it is
19 the incumbent local exchange carrier serving the customer
20 directly or it is a competitive local exchange carrier
21 leasing those same facilities. The cost of a loop should
22 be the same in either case. The effect of calculating
23 universal service subsidies and network element prices from
24 different cost studies or geographic areas would be a
25 competitively distorted universal service fund.

1 In order for a fund to be competitively neutral,
2 both the unbundled network element based entrant and the
3 incumbent should receive the same effective subsidy.
4 However, if competitive providers pay UNE prices based on
5 one cost analysis and geographic aggregation and subsidies
6 to support universal service are created in a different
7 manner, then there would be instances in which the subsidy
8 available to the competitive provider is different from
9 that provided to the ILEC.

10 I recommend the cost proxy model, the HAI model
11 specifically be used to determine costs in geographic areas
12 served by the non-rural local exchange companies. These
13 are BellSouth, GTE, United and Centel. Based on the HAI
14 model, the total forward-looking cost to provide universal
15 service for areas served by BellSouth in Florida is
16 approximately 695 million. This equates to an average of
17 14 -- of \$15.43 for primary residential line per months.
18 The total cost to provide universal service for areas
19 served by GTE in Florida is approximate 260 million. This
20 equates to \$15.37 for primary residential line per month.
21 The cost for areas served by United in Florida is
22 approximately 224 million, or \$19.08 for primary
23 residential line per month. The cost for areas served by
24 Centel is approximately 70 million dollars or \$26.87 per
25 primary residence line per month.

1 This Commission should adopt the HAI model to
2 determine the forward-looking economic cost to provide
3 universal service and provide these costs to the
4 legislature. These costs should be aggregated consistent
5 with unbundled network element, currently statewide average
6 costs, and this completes my summary.

7 MR. HATCH: Madam Chairman, the witness is
8 available for cross.

9 CHAIRMAN JOHNSON: Okay. Any questions?

10 MR. MELSON: No questions.

11 MR. WAHLEN: No questions.

12 MR. POWELL: Madam Chair, with your indulgence,
13 we go in reverse order?

14 CHAIRMAN JOHNSON: That's fine.

15 CROSS EXAMINATION

16 BY MS. KEYER:

17 Q Mr. Guepe, I'm Mary Keyer with BellSouth, and I
18 do have some questions for you this afternoon.

19 A Okay, could you speak up a little bit? I
20 can't --

21 Q Is that better? Can you hear me now?

22 A Now it's fine.

23 Q On Pages 3 and 4 of your direct testimony, you
24 have outlined the issues which are to be addressed in this
25 docket; is that correct?

1 A That's correct.

2 Q And those issues are those that were set forth by
3 this Commission to be addressed by the parties in this
4 docket; is that right?

5 A Okay, those are the issues from the -- yes, from
6 the staff.

7 Q Now when you look at that list of issues, isn't
8 it true, Mr. Guepe, that a lot of your testimony addresses
9 issues that are not listed on that issue list, that are
10 actually outside the issue list?

11 A No, I believe they are relevant to it because
12 they all touch on the question of a universal service
13 subsidy, and once you develop -- in the development of the
14 costs, you have to know how those costs are used as well as
15 the costs themselves. In order to, I believe, to make a
16 recommendation to the legislature, the Commission should
17 furnish that information.

18 Q But the -- nowhere on this issue list is the
19 basis to determine subsidy needs listed, is it?

20 A It's not on this particular issue list, no, but
21 it is relevant --

22 Q Thank you.

23 A -- to the idea of if you're going to make a
24 recommendation as costs used in the determination of a
25 permanent universal service mechanism.

1 Q You answered my question, Mr. Guepe. Thank you.
2 Nor is revenue benchmarking included on that list
3 either, is it?

4 A No, it is now; however, it is still relevant to
5 the issues at hand.

6 Q Now on Page 6 of your direct testimony, Lines 8
7 to 17, you have cited to Florida Statute, Section
8 364.02(2) that defines basic local service; is that
9 correct?

10 A That's correct.

11 Q And you agree, don't you, that essentially basic
12 local service is what is included in the definition of
13 universal service?

14 A For universal service for -- It's close, yes,
15 but for universal service purposes, you have to understand,
16 as Mr. Gillan had explained, when you are looking at
17 universal service and the costs that you are going to be
18 reporting for universal service, all the costs of the loop
19 and the switch and all the services associated should be
20 included in that.

21 Q But essentially basic local service is what is
22 included in the definition of universal service, isn't it?

23 A Okay, repeat that, please.

24 Q Essentially basic local service is what is
25 included in the definition of universal service?

1 A Yes, I mean universal service is --

2 Q Okay.

3 A As the statute has said, it's an evolving level
4 of services, so it's something that this Commission can
5 look at it in this hearing and actually make a
6 recommendation, I believe, to the legislature as to what it
7 believes should be supported.

8 Q Okay. The definition of universal service does
9 not include vertical services, does it, Mr. Guepe?

10 A The definition of -- Repeat that.

11 Q The definition of universal service does not
12 include vertical services, does it?

13 A I think the definition of universal service,
14 what's in the statute calls it an evolving level of
15 services, so you have to look at, this Commission can
16 determine what that is.

17 Q Mr. Guepe, can you give me a yes or no answer?

18 A Well, I would say -- I can't answer that yes or
19 no because it's not a yes or no question. Is it included
20 in universal service? And the definition of universal
21 service is that it's kind of an evolving level. It's
22 something that is to be determined, and I don't know if
23 that has been determined here.

24 Q Do you recall answering that exact same question
25 when you testified before the North Carolina Utilities

1 Commission in June of 1998 when you were asked: Now the
2 definition of universal service does not include vertical
3 services, does it? You responded no?

4 A Okay, I do not recall, but if that's what the
5 transcript shows, I accept that.

6 Q Would you also agree, Mr. Guepe, that the
7 definition of universal service does not include toll
8 services either, does it?

9 A Once again, we are back to in Florida the
10 definition is open -- I believe that's an open question as
11 far as how that --

12 Q Pardon?

13 A In Florida, Florida statute defines it as being
14 an evolving level. It does not say exactly what universal
15 service is.

16 Q Okay. In North Carolina, does the definition of
17 universal service include toll services?

18 A If I recall, in North Carolina the definition had
19 been stated, and it did not include toll services, that's
20 correct.

21 Q Mr. Guepe, on Page 56 your direct testimony, you
22 state that if universal service subsidies are required,
23 then the Telecommunications Act requires they be explicit;
24 is that correct?

25 A That's correct.

1 Q And, in fact, the Act, section 254E states that,
2 quote, such support should be explicit and sufficient to
3 achieve the purposes of this section, doesn't it?

4 A That sounds correct, yes.

5 Q Now, again, going back to your North Carolina
6 testimony, you testified that you had no opinion as to
7 whether that language prohibits implicit subsidies. Is
8 that still your testimony?

9 A I think that goes into because I'm not sure what,
10 quote, an implicit subsidy is. It means it's not defined.
11 We don't know what it is, so it really doesn't --

12 Q So do you still have no -- Oh, excuse me.

13 A So the Act really doesn't address implicit
14 subsidies.

15 Q So you still have no opinion as to whether the
16 language prohibits implicit subsidies?

17 A The language of the Act requires that subsidies
18 be explicit, that's correct.

19 Q Okay. Now does AT&T believe that all carriers
20 must provide universal service?

21 A Explain that.

22 Q Well, does AT&T believe that an eligible
23 telecommunications carrier should have obligations to be a
24 carrier of last resort?

25 MR. HATCH: Madam Chairman, I'm going to object

1 at this point. If we are going to talk about carrier of
2 last resort obligations, there is a separate statutory
3 provision dealing with that, and it's not before the
4 Commission under the guise of universal service. It's
5 beyond the scope of his testimony.

6 MS. KEYER: Well, I think that Mr. Guepe has
7 testified as to what he thinks should be included in terms
8 of subsidies, in terms of revenues, and Mr. Gillan
9 testified as to what customers should be served, et cetera,
10 and this line of questioning will be relevant to those.

11 CHAIRMAN JOHNSON: What was your question again?

12 MS. KEYER: Does AT&T believe that all carriers
13 have to provide universal service, or that they have
14 obligations to be a carrier of last resort.

15 MR. HATCH: If she is asking the question who
16 should be an eligible carrier to receive universal service
17 funding, that is well beyond the scope of this proceeding
18 and beyond the scope of Mr. Guepe's testimony. She is
19 asking for carrier of obligation responsibilities. Again,
20 it's beyond the scope of his testimony and well beyond the
21 scope of this proceeding.

22 CHAIRMAN JOHNSON: You need to repeat your
23 question for me one more time because it appeared like
24 there were two questions in there.

25 MS. KEYER: Well, there were. One is does AT&T

1 believe all carriers must provide universal service?

2 CHAIRMAN JOHNSON: Okay.

3 MS. KEYER: And then I had a follow-up question
4 on that, do they believe -- does AT&T believe an eligible
5 telecommunications carrier should have obligations to be a
6 carrier of last resort?

7 CHAIRMAN JOHNSON: I'm going to allow both
8 questions, and to the extent that you know the answer, you
9 can answer. If you don't, you don't have to.

10 A Okay, repeat the first one. We'll go one at a
11 time.

12 BY MS. KEYER (Continuing):

13 Q Does AT&T believe that all carriers must provide
14 universal service?

15 A Well, as I understand all carriers, that would
16 be cellular carriers, it could be any carriers, so that
17 means -- I mean unless you are an eligible
18 telecommunications carrier, you are not even maybe
19 providing local service.

20 Q So is your answer no?

21 A So for all interexchange carriers to say you have
22 to provide local service, no.

23 Q Can you answer my second question: Does AT&T
24 believe an eligible telecommunications carrier should have
25 obligations to be a carrier of last resort?

1 A Section 214 of the Act defines the obligations of
2 eligible telecommunications carriers. It doesn't use the
3 term "carrier of last resort." It does have conditions
4 under which, if you are an eligible telecommunications
5 carrier, you can enter or get out of the market. So there
6 are safeguards in there. So when you are using "carrier of
7 last resort," I'm not sure exactly what you are saying; so,
8 no, I would not agree with that. I would say what section
9 214 of the Act should apply.

10 Q Now Mr. Guepe, as I understand your testimony,
11 AT&T believes that the cost of universal service should be
12 determined on a wire center basis; is that correct?

13 A That's correct. It's the logical place. The
14 wire center is the one -- it's the fixed point of both
15 model's analysis. You are starting with a fixed wire
16 center.

17 Q Do you believe that AT&T or any new entrant
18 should have to serve everyone in that wire center who wants
19 service?

20 A You're getting back to an eligible
21 telecommunications carrier, I believe. I mean I'm looking
22 for understanding because, if a carrier is not an eligible
23 telecommunications carrier, then they are not going to have
24 that obligation. If they are an eligible
25 telecommunications carrier, they are going to have the

1 obligation to serve the area that is really determined by
2 the Commission. I believe the commission has decided that
3 when a new entrant comes into the market what that serving
4 area should be would be decided at that point in time.

5 Q Mr. Guepe, isn't it AT&T's position that it or
6 any new entrant can pick and choose which customers it
7 wants to serve? That if it wants to go after the
8 profitable customers, it can do that? Isn't that your
9 position, and hasn't that been your testimony?

10 A If a carrier comes into the market, I mean if --
11 and they don't have to be an eligible telecommunications
12 carrier. Someone could come in the market and serve 10
13 people, and that's all. They would never get any universal
14 service support for that.

15 Q Would they need universal service support if they
16 are coming in serving all the low cost high profit
17 customers?

18 A Well, I'm not sure about your characterization
19 because, if they are coming in under unbundled network
20 elements, there is no low cost. It's the same cost
21 wherever they serve in the state.

22 Q So your answer is that AT&T does, in fact,
23 believe that a new entrant or AT&T could come in and serve
24 whichever customers it wanted to serve; isn't that right?

25 A I think that's just a statement of reality. I

1 don't believe anybody could say otherwise, if a carrier
2 comes into the market. Now if they want to be eligible for
3 universal service, they are going to have to meet the
4 conditions that are set forth -- if a fund is established
5 here, as set forth by the Commission.

6 CHAIRMAN JOHNSON: What was -- you made a comment
7 about the unbundled network elements but I didn't hear your
8 response to one of her questions.

9 MR. GUEPE: With statewide average of unbundled
10 network elements, if a competitor comes into the market
11 right now, wherever they are serving in the state, they pay
12 one rate. There is no high cost and low cost for a carrier
13 coming in using unbundled network elements.

14 CHAIRMAN JOHNSON: Okay.

15 MS. KEYER: Madam Chairman, are you through?

16 CHAIRMAN JOHNSON: Oh, yeah, I'm sorry.

17 BY MS. KEYER (Continuing):

18 Q According to you, Mr. Guepe, and AT&T, aren't you
19 saying that AT&T should have the flexibility to go in and
20 take the high-income customers and serve them but not
21 necessarily the low-income customers?

22 A No, if AT&T is providing local service, if and
23 when the market is truly open and we are ready, we are able
24 to get into the market, and as an eligible
25 telecommunications carrier, AT&T would have to offer

1 service to everyone. We couldn't say, oh, you're high
2 income, we'll take you. You are low income, we don't want
3 you.

4 Q Do you recall testifying in Tennessee before the
5 Tennessee regulatory authority?

6 A Yes, I do.

7 Q In December of 1997?

8 A Yes, I do.

9 Q Okay. Do you remember being asked this same
10 question, and this was your answer? This is on page 121
11 beginning at line 8: Do you believe that AT&T or any other
12 new entrant should have the flexibility to say, okay, we
13 are going to take this area that has the high-income
14 customers and we are going to serve that, but we are going
15 to elect not to serve the low-income customers. Should you
16 have the latitude to do that in your view? And please give
17 me a yes or no before you explain. Answer: Yes.

18 A Yes, I recall that, and if you look at the full
19 transcript as it goes on, you'll find out that when AT&T
20 enters the market as an eligible telecommunications carrier
21 they are obligated to serve all those customers.

22 Q Okay. Now does AT --

23 CHAIRMAN JOHNSON: And by that, the distinction
24 that you are making is that eligible telecommunications,
25 ETC? Because I guess you're saying once we have designated

1 them an ETC they can receive universal service support?

2 WITNESS GUEPE: Yes.

3 CHAIRMAN JOHNSON: And if they receive universal
4 service support, then they have to serve everyone in the
5 Commission designates as the area?

6 WITNESS GUEPE: Yes.

7 CHAIRMAN JOHNSON: But if they're not --

8 WITNESS GUEPE: Theoretically any carrier,
9 whether -- and I was answering that in terms of -- I think
10 the transcript would show that in terms of any carrier
11 coming into the market.

12 CHAIRMAN JOHNSON: But if they are not, if they
13 are just a competitor who does not, who hasn't been
14 designated as an eligible telecommunications carrier, does
15 not receive any universal service funds, then they come in
16 and serve -- they can come in and, for lack of a better
17 word -- well, they don't have the obligation to serve the
18 whole area?

19 WITNESS GUEPE: That's correct.

20 BY MS. KEYER (Continuing):

21 Q So they basically forego the universal service
22 fund support and serve the high revenue customers?

23 A If someone knows, quote, what the high revenue
24 customers are. When you are a new entrant, generally you
25 don't know who the high -- You've got -- The residential

1 market is a mass market. In order to serve it
2 successfully, you are going to have to serve a large
3 portion of that market, and you are going to have really to
4 advertise to all those customers.

5 Q Mr. Guepe, does AT&T plan to charge a minimum for
6 local service like it has done for long distance?

7 A I don't know what our local service plans are. I
8 mean if you are in the local market, you are going to be
9 charging the base -- some basic rates, so you are going to
10 have a minimum charge. I mean by the fact that you are a
11 local service provider, you have a set of customers that
12 you are guaranteed a certain amount from. I mean you are
13 going to be selling them other services too, so you are
14 going to be looking for a revenue stream, but you have a
15 fixed -- I don't understand -- I don't understand the
16 question.

17 Q Well, doesn't AT&T charge a \$3 minimum on long
18 distance?

19 A You are going to have to give a little more
20 details on it. For every customer, no, I don't think they
21 do this for every -- do that for every customer.

22 COMMISSIONER CLARK: Who don't they charge that
23 to?

24 WITNESS GUEPE: From my knowledge of it, being an
25 existing customer, I know I don't get a minimum charge.

1 COMMISSIONER CLARK: Well, I thought you were
2 either going to be charged \$3, whether or not you make \$3
3 worth of calls, that that is going to be the charge.

4 WITNESS GUEPE: I don't believe for existing
5 customers that is true.

6 COMMISSIONER CLARK: Oh, I see, okay.

7 WITNESS GUEPE: I believe, and I'm not even sure
8 of this, and we are kind of getting off the point of this
9 hearing, that it was new customers.

10 COMMISSIONER DEASON: But I don't understand how
11 that is relevant to local service. The way local service
12 is priced, it's a minimum charge whether you stay on the
13 phone 24 hours a day or you never make a call.

14 WITNESS GUEPE: I agree. I didn't ask the
15 question.

16 BY MS. KEYER (Continuing):

17 Q Well, AT&T could say that they are not going to
18 serve a local customer unless there is a minimum of \$20,
19 couldn't they, unless they are going to get \$20 of revenue?

20 A I don't know. I don't see how you could say
21 that.

22 Q Okay. If a universal service fund is found to be
23 necessary, do you agree that all carriers who provide
24 interstate services must contribute?

25 A Yes, all carriers should contribute. I mean

1 that's -- I believe that's by statute.

2 Q Now according to AT&T's position, AT&T is saying
3 that no funds should be established; is that right?

4 A We are saying right now given the current
5 conditions in the market that this Commission should report
6 those conditions to the legislature so that when the
7 legislature is looking at the establishment of permanent
8 universal service fund mechanism it would take that into
9 account.

10 Q And in that case, if there were no fund
11 established, then the cost of universal service would
12 continue to be borne by the incumbent local exchange
13 carriers and their customers, wouldn't it?

14 A No, right now there are no cost pressures on the
15 local exchange carriers, customers, or the fear of losing
16 it. I mean right now profit -- customers are profitable,
17 so the determination of whether there is a subsidy has yet
18 to be made.

19 Q Well, aren't there subsidies right now,
20 Mr. Guepe?

21 A When I look at revenue from residential customers
22 and the cost of residential customers, residential
23 customers cover their costs. Residential revenues exceed
24 the cost. So does the customer subsidize themselves? I
25 mean that's -- I don't know -- I don't see how customers

1 subsidize themselves.

2 Q What about service to service subsidies?

3 A Residential service as a whole is profitable.

4 Q Aren't access services an implicit subsidy?

5 A Access services, when I looked at my analysis,
6 even if you took access out of residential, residential
7 revenue still exceeded residential cost which just told me
8 that access was overpriced.

9 Q My question, Mr. Guepe, is aren't access services
10 implicit subsidies?

11 A As I said --

12 Q Can you answer yes or no?

13 A In Florida I would say no.

14 Q Okay.

15 A And the reason is when I looked at your
16 residential revenues and residential costs and taking out
17 the access, the residential revenues still exceeded the
18 costs, so that just told me access is priced high.

19 Q What about discretionary services?

20 A Discretionary service is a part of the total bill
21 of residential customers.

22 Q I'm sorry, the what?

23 A I mean it's part of the total package that a
24 customer purchased, so whether there is -- you know, it
25 gets back to a customer has vertical -- has vertical

1 services and basic service. Are they subsidizing
2 themselves?

3 Q Mr. Guepe, not every customer orders
4 discretionary services, do they?

5 A I don't know. No, I would say --

6 Q In fact --

7 CHAIRMAN JOHNSON: Hold on. You are going to
8 have to speak one at a time. You are going to have to ask
9 your question and allow him to answer it. And after you've
10 answered your question, then you can respond. And you do
11 need to be -- if you can start your answer with a yes or a
12 no.

13 WITNESS GUEPE: Okay.

14 CHAIRMAN JOHNSON: But you do have the opportunity
15 to expound upon your yes or no answer.

16 WITNESS GUEPE: All right. Thank you. Okay.

17 COMMISSIONER GARCIA: The question was not every
18 customer has -- what was it vertical services,
19 discretionary services?

20 BY MS. KEYER (Continuing):

21 Q Right. Not every customer has vertical or
22 discretionary services, do they?

23 A I would accept that.

24 Q In fact, are you aware that at least 41% of the
25 customers, residential customers in Florida do not obtain

1 vertical services?

2 A I do not know what the percentage is. If you say
3 that is what it is, that doesn't compare real well with the
4 data that BellSouth had filed with the FCC on local service
5 bills where really 91% roughly of customers had bills
6 higher than what the basic local rate is.

7 COMMISSIONER GARCIA: Do you know what they
8 included in those bills? Is that probably long distance
9 also?

10 WITNESS GUEPE: No, that was just local.

11 COMMISSIONER GARCIA: That was just local.
12 Because I like you remember that number being higher, 41%.
13 I mean that number being lower, 41%, but I'm sure BellSouth
14 will have a witness.

15 WITNESS GUEPE: Can speak to it.

16 COMMISSIONER DEASON: Do you consider ECS local
17 or toll revenue?

18 WITNESS GUEPE: I think they were included in --
19 well, I don't know. It was BellSouth data. It might have
20 been in there. I don't know.

21 COMMISSIONER DEASON: Your 91% had bills more
22 than the minimum?

23 WITNESS GUEPE: Yes.

24 COMMISSIONER DEASON: And do you know whether
25 that included ECS revenue or not?

1 WITNESS GUEPE: It would have included -- It was
2 called EAS, so I don't know of ECS is considered EAS. I
3 don't know.

4 COMMISSIONER DEASON: Well, EAS is normally
5 included for a flat amount and sometimes there is an
6 increment on the bill, and sometimes there is not. ECS is
7 usually in terms of 25 cents per call, but it's your
8 understanding that probably included that type revenue?

9 WITNESS GUEPE: Yeah, I can't answer one way or
10 another on that. I don't know. The source wasn't that
11 specific.

12 BY MS. KEYER (Continuing):

13 Q Mr. Guepe, states are not required to set the
14 revenue benchmark in the same way that the FCC ultimately
15 chooses; isn't that right?

16 A No, the states can do -- can set up a system as
17 they want to, so it's up to the Florida legislature.

18 Q Now I think -- is AT&T also taking the position
19 that intraLATA toll should be included in the benchmark?

20 A Yes.

21 Q Are you aware that 82% of BellSouth's residential
22 customers make no intraLATA toll calls during a month?

23 A If you say so.

24 Q Doesn't the inclusion of access toll and vertical
25 service revenue in the benchmark only embed the implicit

1 subsidies that are to be made explicit?

2 A No.

3 Q If there is no universal service fund or the fund
4 is inadequate to support every line in the high-cost areas,
5 you would not expect new entrants to want to serve
6 customers, would you?

7 A We -- I don't know the answer to that, and I'll
8 say why, because we -- the local market isn't really open
9 to competition, so we don't know what it's going to look
10 like.

11 Q I want to take you back to the Florida statute,
12 364.02(2) that you cited in your direct testimony. I
13 believe it's on Page 6.

14 A Okay.

15 Q That defines basic local telecommunications
16 service, doesn't it?

17 A Okay, my understanding is that this definition
18 was put in really at the same time that the -- what was it,
19 the 1995, I guess, legislation which enabled alternative
20 regulation. And in the alternative regulation, it refers
21 to basic local service. These are things which if you are
22 going to, the alternative were regulated, you are going to
23 have to cap your services, cap your basic local service,
24 which means you are going to have to provide these. So in
25 my mind it's in terms of alternative regulation and what

1 needs to be provided. But, yes, that's what is in there.

2 Q Okay. And that is the definition for basic local
3 telecommunications service, is it not? If you are -- You
4 can look on Page 6 of your direct.

5 A Yes, that's what's in the Florida statute.

6 Q Okay. And it does not in that definition that's
7 in your testimony at Page 6 beginning on line 9, that does
8 not include vertical services in that definition, does it?

9 A No, I believe we went through this earlier.

10 Q Okay. Part of -- AT&T has proposed that access
11 charges be substantially dropped, have they not?

12 A You mean in Florida, or what?

13 Q Well, in Florida and everywhere.

14 A I mean in Florida they are controlled, I believe,
15 by the legislature.

16 Q Has AT&T proposed that they be dropped and that
17 they be driven closer toward cost?

18 A AT&T has proposed that in jurisdictions, yes.

19 Q And to the extent that access charges are, in
20 fact, reduced, they should not be considered in the revenue
21 benchmark, should they?

22 A That's true, and the revenue benchmark which I
23 had laid out excluded that. It showed them reduced to
24 cost.

25 Q And aren't intraLATA toll service revenues

1 subject to competitive erosion?

2 A I don't know because the market has been -- you
3 know, more and more people make toll calls. I don't know
4 whether you could say it's subjected any more than it has
5 been to competitive erosion. I know that -- I believe the
6 commissioner had mentioned the ECS calls which used to be
7 toll are now -- well, I think they are considered local, at
8 least that's how BellSouth books the revenues, so they are
9 really protected, so I'm not sure I would say the intraLATA
10 toll is subject to erosion.

11 Q Okay. I have just a couple more questions. You
12 also include yellow page advertising; is that right?

13 A Yes, I think yellow page advertising should be
14 included in that because Judge Green specifically gave it
15 to the RBOCs at divestiture saying yellow pages are used to
16 support local service, so it should be continued there, so
17 it should be part of the revenue benchmark. It is part of
18 the revenues that the local companies receive.

19 Q And they are not included though in the revenue
20 benchmark set by the FCC for the federal fund, were they?

21 A No, I don't believe they are.

22 MS. KEYER: I don't have any other questions.

23 CROSS EXAMINATION

24 BY MR. REHWINKEL:

25 Q Good afternoon, Mr. Guepe. My name is Charles

1 Rehwinkel with Sprint.

2 A Good afternoon.

3 Q Just to follow up on a couple of questions Ms.
4 Keyer asked you. You do agree that the legislature did not
5 ask the Commission to report on the need for a fund, do you
6 not?

7 A The statute states to assist the legislature in
8 establishing a permanent universal service commission, they
9 are asking the Commission to do certain things. So in
10 order to do those things, the more information, I believe,
11 that the Commission can provide them, the better off the
12 legislature and the Commission both are.

13 Q So is your answer yes or no that they did not ask
14 for the Commission to report on the need for a fund?

15 A Correct.

16 Q Okay. And they did not ask the Commission to
17 give its opinion about what revenue benchmark ought to be
18 used; is that correct?

19 A They did not directly ask for it, that's correct;
20 but I believe it's -- when you are talking about the cost
21 to be reported, it's relevant to consider how those costs
22 should be used.

23 Q And you would agree that the legislature did not
24 ask the Commission -- Strike that.

25 Would you refresh my recollection on what you

1 said about whether vertical services are included in
2 universal service?

3 A When you are looking at the cost to be compared
4 with the revenues, okay, vertical services are in the
5 Hatfield Model. They are part of the full cost of
6 providing the service and those should be compared to all
7 of the revenues, so to be consistent your vertical services
8 would be included in the revenues that would be compared to
9 the costs.

10 Q Nowhere in the directive to the Commission in
11 House Bill 4785 did the legislature designate that vertical
12 services are included in universal service, did they?

13 A No.

14 Q Mr. Guepe, when local competition comes to
15 Florida on a large scale, it won't be on a territory-wide
16 basis, will it?

17 A I'm having trouble with your question because you
18 said -- if I understood what you said, when it comes on a
19 large scale it won't be on a what basis?

20 Q Territory-wide basis.

21 A Well, it's -- if it's on a large scale, that
22 tells me that it is on a --

23 Q Would that be your definition of what large scale
24 competition would be, that it would be pervasive throughout
25 an ILEC's serving territory?

1 A Large scale competition would mean it's
2 throughout the state or, you know, not every nook and
3 cranny, but a good portion of the state.

4 COMMISSIONER CLARK: I think you are talking past
5 each other, and I don't understand. You are asking will it
6 be coterminous with the territory of existing ILECs?

7 MR. REHWINKEL: I can ask the question another
8 way. I understand my miscommunication.

9 COMMISSIONER GARCIA: I would like to know what
10 coterminous means.

11 COMMISSIONER CLARK: Are you going to tell him,
12 Mr. Rehwinkel?

13 MR. REHWINKEL: I think it means duplicating the
14 borders.

15 BY MR. REHWINKEL (Continuing):

16 Q A rational entrant will not go into the local
17 competition business by serving an entire ILEC serving
18 territory at once, will it?

19 A I don't know. It depends on when the conditions
20 are there to get into the market --

21 Q Do you understand --

22 A -- like they are really there. So I don't know
23 what the plans would be or how they would do it.

24 COMMISSIONER GARCIA: As a general rule, when
25 your company gets into a market I would assume that it's

1 exactly the opposite of what he is saying. In other words,
2 a company of your size puts out an ad and you usually take
3 on most comers because the way you market your product is
4 on a general basis, right?

5 WITNESS GUEPE: Local service in particular is
6 a -- I mean it is a mass market. If you are going to get
7 into it, you are going to get into it.

8 BY MR. REHWINKEL (Continuing):

9 Q Mr. Guepe, you've used -- you've advanced to the
10 Commission a netting process for evaluating the need for a
11 fund; is that correct?

12 A That's correct.

13 Q Have you reviewed Mr. Wood's revised exhibit,
14 DJW-5 that shows the output results on a wire center basis?

15 A Yes.

16 MR. REHWINKEL: I would like to pass an exhibit
17 out, Madam Chairman, for identification purposes only. I
18 don't intend to offer this into evidence because I think it
19 will be coming later on.

20 COMMISSIONER GARCIA: I'm sorry, Charles, I was
21 on the phone. What is it that you are passing out?

22 MR. REHWINKEL: This is just Mr. Wood's revised
23 Exhibit 5. I just want to use it for discussion purposes
24 only.

25 CHAIRMAN JOHNSON: And before you do that,

1 perhaps you could help me out. I always get these things
2 confused. What is AT&T's suggestion as to the measure of
3 cost? Is it wire center, on a wire center basis is what
4 AT&T is advocating?

5 WITNESS GUEPE: When you are developing the cost,
6 do it on a wire center basis, yes.

7 CHAIRMAN JOHNSON: As opposed to what?

8 WITNESS GUEPE: A CBG basis.

9 CHAIRMAN JOHNSON: And a wire center is larger
10 than a CBG. What is a wire center?

11 WITNESS GUEPE: A wire center is where the
12 central office is located, and it's all the areas that are
13 served around it. It's the lines from a given office out
14 to the boundary of it, and you've got -- say within a
15 larger metropolitan area, you might have several wire
16 centers; and if it's a small city, you just might have one,
17 and so it's really just that one exchange. So it's all the
18 different exchanges within --

19 CHAIRMAN JOHNSON: Okay. But you all don't
20 advocate study area.

21 WITNESS GUEPE: When you are -- Given today's
22 market conditions, where you don't have any price
23 pressures, where there is no one that is coming into the
24 market, that market is not open, the appropriate way to
25 look at it is on a study area basis really for a given

1 company.

2 CHAIRMAN JOHNSON: But not -- I'm sorry, why is
3 the position, AT&T's position wire center and not study
4 area?

5 WITNESS GUEPE. Okay. When you are developing
6 the costs themselves through the model, you have to start
7 at some level, and it makes sense to do it at the -- to
8 look at cost wire center by wire center because the wire
9 centers, in the model, that's the fixed location. That's
10 the one thing that is your starting point of the model.
11 It's saying take the existing wire centers, build
12 facilities out to serve all the customers.

13 CHAIRMAN JOHNSON: And a study area in that
14 context is too large?

15 WITNESS GUEPE: And a study area is too large, so
16 you do it that way. But for the purposes of given today's
17 market conditions, it's appropriate to look at the entire
18 study area for a given company. So you would aggregate
19 those costs wire center by wire center.

20 CHAIRMAN JOHNSON: I see what you're saying.
21 Yeah, I'm following you.

22 COMMISSIONER JACOBS: Would the criteria vary
23 across companies for the wire counts or the geographic --
24 geography that would be covered by a wire center, or is it
25 pretty much an engineering kind of --

1 WITNESS GUEPE: For the non-rural companies we
2 would advocate that in each case it would be aggregated
3 across all of their wire centers.

4 COMMISSIONER JACOBS: No, I mean how likely is it
5 that one company's -- the makeup of a wire center in one
6 company would differ significantly from the makeup of a
7 wire center in another company? Are those pretty much
8 engineering configurations?

9 WITNESS GUEPE: The costs, I think, vary
10 considerably. You know, it's a percent different from
11 wire center to wire center. I don't know. Maybe that
12 would be a better question to talk to Don Wood about. The
13 different wire centers in topographically different areas
14 would have different costs.

15 COMMISSIONER JACOBS: Thank you.

16 BY MR. REHWINKEL (Continuing):

17 Q Mr. Guepe, are you generally familiar with the
18 Centel territory within Sprint-Florida and the United
19 territory within Sprint-Florida's searching area.

20 A I think United is more in the kind of south of
21 Orlando and out through that area.

22 Q Generally --

23 A I mean I'm asking because this is my perception,
24 and the Centel is really up in this area.

25 Q Yes, generally around Tallahassee, Ft. Walton

1 Beach and some areas between, some rural areas around
2 Bonifay and Marianna.

3 A Okay, and that's Centel.

4 Q And are you also aware that the rate structures
5 for both companies are different, both territories?

6 A I'll take your word for it.

7 Q Okay. And will you accept my word for it that
8 the exchanges in the -- well, strike that.

9 You have, on page, in your testimony at Page 18
10 recommended that the need for fund be analyzed with
11 reference to a revenue benchmark per line of \$35.64; is
12 that correct?

13 A That's correct.

14 Q And that's essentially the numbers you calculated
15 around line 6 adjusted for access being taken to cost?

16 A Correct.

17 Q Okay. And that is an average number of both
18 United and Centel territories; is that correct?

19 A That is correct, and that's because I didn't have
20 specific United and specific Centel data.

21 Q Okay. Just before, to follow that line of
22 question, let me ask you about the \$24.98 of local service
23 revenue for United and Centel.

24 A Okay.

25 Q That is significantly higher than BellSouth and

1 GTE, is it not?

2 A It is. It's what was reported to the FCC. I'm
3 just taking numbers that were reported.

4 Q Okay. And you don't know whether there are ECS
5 revenues in that?

6 A No, I do not.

7 Q Okay. Is it your position that there should be
8 no fund because the \$35.64 figure that you have calculated,
9 when multiplied by the total number of access lines is
10 greater than the wire center developed cost produced by the
11 HAI model for United in Centel territories?

12 A That was correct. That's the math.

13 Q Okay. The exhibit that I passed out --

14 MR. REHWINKEL: Should we give this an exhibit
15 number, Madam Chairman?

16 CHAIRMAN JOHNSON: Do you want it --

17 MR. REHWINKEL: We don't have to. I just --

18 CHAIRMAN JOHNSON: It doesn't matter. Exhibit
19 Number 42.

20 MR. REHWINKEL: 42, okay.

21 BY MR. REHWINKEL:

22 Q If you could turn to the last page of Exhibit
23 42. Up at the top it should say Centel Wire Center?

24 A Okay.

25 Q And I don't expect you to know the names of the

1 wire centers. I think I know the names of all of them, if
2 I can represent to you what they represent. But under
3 your analysis if profitable customers in low-cost dense
4 areas and more urban areas were lost in the competitive
5 entrant -- to a competitive entrant, would you assume that
6 the \$35.64 average revenue figure would still be a valid
7 benchmark to compare your cost to?

8 A You would have to see how the market developed.
9 I mean what this recommendation is saying, looking at the
10 current market conditions, these are the conditions, this
11 is the result; and until those market conditions change,
12 this is going to be on the result.

13 Q So you would have to see whether the company lost
14 customers and was in a position to need support before you
15 would revisit it?

16 A I think once the market became open to a
17 competition it might be time to revisit it, but right now
18 there isn't any.

19 (Whereupon, the transcript continues in Volume 6
20 without omission)

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