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September 10, 1999

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Mrs. Blanca S. Bayo, Director
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Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

Re: Docket No. 990649-TP

Dear Mrs. Bayo:

Enclosed for filing in the above-referenced docket are an original and fifteen (15) copies of the rebuttal testimony of Dr. August H. Ankum on behalf of AT&T Communications of the Southern States, Inc. and MCI WorldCom, Inc.

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

Thank you for your assistance with this matter.

Yours truly,

Tracy Hatch

TH:kfj
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CERTIFICATE OF SERVICE
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ORIGINAL

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 990649-TP

REBUTTAL TESTIMONY

OF

DR. AUGUST H. ANKUM

ON BEHALF OF

AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.

AND

MCI WORLDCOM, INC.

September 10, 1999

REBUTTAL TESTIMONY OF

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AND

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DOCKET NO. 990649-TP

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is Dr. August H. Ankum. I am Senior Vice President of QSI Consulting, Inc., a consulting firm specializing in economics and telecommunications issues. My business address is 1350 North Wells, Suite C501, Chicago, Illinois 60610.

Q. ARE YOU THE SAME DR. AUGUST H. ANKUM THAT PREVIOUSLY FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to some of the issues raised by other parties who filed testimony in this proceeding. Specifically, I will respond to issues raised by the witnesses of BellSouth and GTE.

PRICES SHOULD BE SET EQUAL TO ECONOMIC COST, WHICH IS TSLRIC PLUS A REASONABLE ALLOCATION OF FORWARD-LOOKING SHARED AND COMMON COSTS

Q. DOES BELLSOUTH PROVIDE A DEFINITION OF ECONOMIC COST THAT IS GENERALLY CONSISTENT WITH THE DEFINITION OF ECONOMIC COST YOU PRESENTED IN YOUR DIRECT TESTIMONY?

A. On page 24 of his testimony, BellSouth witness Varner states: "In this case, economic costs are defined as TSLRIC plus an allocation of shared and common costs." This definition, in general, is consistent with the one I discussed in my direct testimony. However, only an examination of BellSouth's TELRIC and shared and common cost studies can ensure that the proper TELRIC principles have been applied in practice.

Q. BUT DOES BELLSOUTH RECOMMEND THAT PRICES BE SET SO AS TO RECOVER <u>MORE</u> THAN THE ECONOMIC COST OF PROVIDING UNBUNDLED NETWORK ELEMENTS?

A. Yes. On page 18 of his testimony, BellSouth witness Varner states:

> Prices must be set to cover, at a minimum, the *actual costs* incurred by the Local Exchange Company ("LEC"). … Setting prices that only cover incremental cost, i.e., not compensating the LEC for a portion of its shared, common and *historical costs*, would enable an ALEC to avoid making

any capital investment and incurring all related costs. (Emphasis added.)

Mr. Varner then goes on to discuss why "for several reasons" it is inappropriate to set prices equal to economic cost. (See pages 24 and 25.)

Q. DOES GTE ALSO ADVOCATE THE NOTION THAT UNE PRICES SHOULD RECOVER ACTUAL COSTS?

A. Yes. Much like BellSouth, GTE also advocates that prices for unbundled network elements should recover *actual costs*. For example, on page 3 of his testimony, GTE witness Mr. David G. Tucek states:

> Rather, GTE believes that properly calculated TELRICs provide a reasonable starting point for developing UNE rates, but that the rates themselves must reflect GTE's *actual costs*. (Emphasis added.)

Q. DO YOU AGREE WITH BELLSOUTH AND GTE?

A. No. First and foremost, BellSouth's and GTE's recommendations are inconsistent with the FCC's TELRIC methodology as mandated in the FCC's Local Competition Order. As discussed in more detail below, the FCC has *explicitly* ruled out considerations regarding "actual" costs.

Further, as I explained in my direct testimony in this proceeding, economic efficiency requires that *prices for unbundled network elements be* *set equal to economic cost*. The reasons for this recommendation were the following. Prices set at economic cost:

-- generate results consistent with competitive market outcomes;

-- create the appropriate price signals that will promote overall economic welfare in Florida;

-- induce efficient market entry by ALECs;

-- are non-discriminatory.

BellSouth's and GTE's recommendation that prices be contaminated with historic inefficiencies -- which, in general, BellSouth and GTE themselves will be seeking to eliminate on a forward-looking basis – violates all of these important policy objectives.

Q. PLEASE DISCUSS WHY PRICES THAT RECOVER HISTORIC INEFFICIENCIES ARE INCONSISTENT WITH THE RESULTS OF COMPETITIVE MARKETS.

A. In a competitive market, prices will gravitate toward economic costs. Companies hampered by inefficient operations are forced to either "shape up" or lose market share and see an erosion of their bottom line. It is only a regulated monopolist, such as BellSouth, that is able – with regulatory fiat -- to impose its historic inefficiencies on the marketplace without significant competitive repercussions.

Q. PLEASE DISCUSS WHY PRICES THAT RECOVER HISTORIC INEFFICIENCIES DISTORT PRICE SIGNALS AND DIMINISH OVERALL ECONOMIC WELFARE IN FLORIDA.

A. If prices reflect economic cost, consumers and suppliers will all make decisions regarding consumption and production levels that collectively lead to optimal results. This process that generally leads to maximum, overall economic welfare is often referred to as the workings of "the invisible hand," the famous phrase coined by classical economist Adam Smith.

By contrast, if prices are distorted by embedded inefficiencies, then market participants make decisions based on false information about the true costs to society of producing telecommunications services. Specifically, telecommunications services will be more expensive than they should be in an efficient setting. The result is that consumers will *under-consume* telecommunications services.

Of course, BellSouth's proposed distortions would be particularly harmful to Florida given the increased reliance of companies and consumers on telecommunications services.

Q. PLEASE DISCUSS WHY PRICES THAT RECOVER HISTORIC INEFFICIENCIES INDUCE INEFFICIENT MARKET ENTRY BY ALECs.

A. If prices for unbundled network elements are set at economic costs, ALECs are in position to accurately determine when it is more efficient to invest in constructing their own facilities instead of leasing facilities from BellSouth or other ILECs. By contrast, if prices for unbundled network elements are set artificially high in order to recover embedded inefficiencies, as proposed by BellSouth, then ALECs will conclude that it is cheaper to build their own facilities or that the market is unavailable to them.

The potential harm here is significant as ALECs are induced to expend scarce resources where it would have been more efficient to lease facilities from the ILEC. This is not only wasteful from the perspective of the ALECs but also from that of society at large.

Q. PLEASE DISCUSS WHY PRICES THAT RECOVER HISTORIC INEFFICIENCIES ARE DISCRIMINATORY.

A. The true economic costs incurred by ILECs on a forward-looking basis are measured by TELRIC. Therefore, any costs that deviate from TELRIC, particularly costs that are greater, are discriminatory.

Q. DOES THE ACT OF 1996 APPEAR TO PROHIBIT THE RECOVERY OF HISTORIC AND UNECONOMIC COSTS?

A. Yes. Contrary to BellSouth's assertions that "[t]he Act does not prescribe any specific cost standard" (Varner, page 20) the language of the pricing provisions in the Act appears, from an economist's perspective, to prohibit traditional cost proceedings that include historic costs. Specifically, Section 252(d)(1)(A) provides as follows:

> … the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section –
>
> (A) shall be –
>
> (i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable) …

The operative phrase here is: "*determined without reference to a rate-of-return or other rate-based proceeding.*" Surely, the language of the Act references certain types of cost proceeding that should not be used in the determination of costs. As an economist, I would argue that historic costs are costs as determined in rate-of-return or rate-based proceedings, which are precisely the type of proceedings that appear to be precluded by the language of the Act for purposes of determining the costs for unbundled network elements.

Q. DO THE FCC RULES PROHIBIT THE INCLUSION OF HISTORIC COSTS?

A. Yes. Though I am not an attorney, as an economist it appears to me that the FCC's rules on this issue are explicit and clear. Specifically, in Rule 51.505(d), the FCC finds the following:

(d) *Factors that may not be considered.* The following factors shall not be considered in a calculation of the forward-looking economic cost of an element:

(1) *Embedded costs.* Embedded costs are the costs that the incumbent LEC incurred in the past and that are recorded in the incumbent LEC's books of accounts.

Thus, it appears clear that the FCC in its Local Competition Order explicitly addressed the issue of the ILECs' historic costs and found that such costs are irrelevant and inappropriate for the purpose of determining the appropriate costs for unbundled network elements.

Q. DOES BELLSOUTH MAINTAIN THAT IF PRICES FOR UNBUNDLED ELEMENTS ARE SET EQUAL TO ECONOMIC COST, THEN BELLSOUTH WILL NOT BE ABLE TO EARN A PROFIT?

A. Yes. On page 20 of his testimony, Mr. Varner states: "A profit cannot be realized until the full actual costs of the item are recovered." He then goes on to state that "[c]ost of capital is a cost like any other cost of doing business. It is well accepted that a profit cannot be realized until all costs, including cost of capital, have been recovered." (Varner, page 26.)

Q. DO YOU AGREE WITH MR. VARNER'S ASSERTION THAT THE COST OF CAPITAL DOES NOT REPRESENT A REASONABLE PROFIT?

A. No. In economics, the cost of capital represents a *normal profit* sufficient to *ensure the continued operations* of a firm in a competitive industry. In other words, if a firm earns a profit equal to the cost of capital *and no more*, then that profit is considered a normal level of profit and it is sufficient to ensure the firm's continued operations.

Moreover, any level over and above the cost of capital is considered *super-normal profit*.

Q. IF PRICES FOR UNBUNDLED ELEMENTS ARE SET EQUAL TO ECONOMIC COST – DEFINED AS TELRIC PLUS A REASONABLE ALLOCATION OF SHARED AND COMMON COSTS -- WOULD BELLSOUTH EARN A *NORMAL PROFIT*?

A. Yes. Included in the TELRIC is the cost of capital. As such, a *normal profit* is already included in the TELRIC calculation. If one were to add any returns above the economic costs (which, again, is TELRIC plus a reasonable allocation of share and common costs), then BellSouth would be earning a super-normal profit.

Q. IS THERE ANY VALID POLICY JUSTIFICATION FOR ALLOWING BELLSOUTH TO EARN A SUPER-NORMAL PROFIT?

A. No. First, Section 252(d)(1)(B) states the following:

> ... the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section –
>
> ...
>
> (B) may include a reasonable profit.

As an economist, I believe that a *normal profit* – which is the level of profit that ensures BellSouth's continued operations – is a "reasonable profit." In fact, any profit greater than a normal profit would be a super-normal profit, which I believe would be an *unreasonable level* of profit.

Second, since the unbundled network elements will be purchased by ALECs, which are dependent competitors of the ILEC, it would hardly be reasonable to allow the ILEC to earn super-normal profits *at the expense of its dependent competitors.*

Q. DID THE FCC FIND THAT THE COST OF CAPITAL IS A REASONABLE LEVEL OF PROFIT?

A. Yes. In paragraph 699 of its Local Competition Order, the FCC found the following:

> We find that the TELRIC pricing methodology we are adopting provides for such a reasonable profit and thus no additional profit is justified under the statutory language.

The FCC then goes on to note that

> profit is defined as 'the excess of returns over expenditure in a transaction or a series of transactions.' This is also known as a

> 'normal' profit, which is the total revenue required to cover all costs of a firm including its opportunity costs… . We conclude that the definition of 'normal' profit is embodied in 'reasonable profit' under Section 252(d)(1).

In short, BellSouth's testimony seems to be at odds with both standard economic theory and the FCC's Local Competition Order.

Q. HASN'T THIS COMMISSION ALREADY RULED IN PREVIOUS DECISIONS THAT EMBEDDED COSTS ARE INAPPROPRIATE IN A FORWARD-LOOKING COST MODEL AND SHOULD NOT BE INCLUDED IN SETTING RATES AND CHARGES FOR UNBUNDLED NETWORK ELEMENTS?

A. Yes. In Order PSC-98-0604-FOF-TP issued on April 29,1998, this Commission found that the recovery of embedded costs is inappropriate in a forward-looking cost model. The Commission agreed with AT&T and MCI that by including the proposed Residual Revenue Recovery additive in BellSouth's proposed rates for loops and ports, BellSouth appeared to desire to be made whole as if it were a rate-of-return regulated company. What BellSouth is proposing here would simply be another attempt to guarantee recovery of its embedded costs, and the Commission should reaffirm its previous decision on this issue.

Q. DOES BELLSOUTH APPEAR TO ADVOCATE THAT PRICES BE SET ABOVE ECONOMIC COSTS AND IN RELATIONSHIP TO OTHER, SIMILAR SERVICES?

A. Yes. I have already discussed that BellSouth is advocating that prices be set above economic costs to recover embedded inefficiencies, to earn super-normal profits and/or erect uneconomic barriers to local entry, thereby maintaining existing super-normal profits. In addition to these distortions, BellSouth is putting forth another reason for setting prices in excess of economic costs. On page 25 of his testimony, Mr. Varner states the following:

> Another consideration is that prices must also be functional in the marketplace and be *consistent with prices for similar services*. (Emphasis added.)

Q. PLEASE COMMENT ON BELLSOUTH'S RECOMMENDATION THAT PRICES FOR UNBUNDLED ELEMENTS BE SET IN RELATIONSHIP TO OTHER SERVICES.

A. BellSouth's proposal here is inappropriate. As I have already discussed at some length, prices should be set at economic costs in order to accomplish a number of important policy objectives. Furthermore, the notion that prices for unbundled elements should be set in relationship to other similar services is particularly inappropriate given that BellSouth is a monopoly, or near monopoly provider and there is no reason to believe that other "similar services" are priced so as to provide acceptable benchmarks for unbundled elements.

Q. DOES BELLSOUTH RECOMMEND THAT PRICES FOR PREEXISTING COMBINATIONS OF UNEs BE SET AT FULL MARKET VALUE?

A. Yes. BellSouth maintains that there is no FCC policy for pricing preexisting combinations of unbundled network elements. Specifically, on page 22 of his testimony, Mr. Varner states:

> With regard to preexisting combinations of UNEs, this Commission is free to establish the appropriate prices. The FCC does not currently have any pricing rules applicable to combinations of UNEs. Consequently, this Commission can set those prices at an appropriate level as permitted by the 1996 Act. (Varner, p. 22.)

He then goes on to note that

> [s]uch a policy requires, at a minimum, that UNE prices cover the full actual costs of the elements and that prices for preexisting combinations of UNEs be set at *full market value*. (Varner, p.21.) (Emphasis added.)

Q. HOW SHOULD COMBINATIONS OF NETWORK ELEMENTS BE COSTED AND PRICED?

A. Combinations of network elements should be costed and priced in the same manner as unbundled network elements: the costing methodology should be TELRIC and prices should be set at economic cost, which is TELRIC plus a reasonable allocation of shared and common costs.

Further, the economic costs for providing combinations of network elements should be determined as the sum of the economic costs for providing the constituent network elements, less any costs that would be eliminated when providing elements that are already combined by the ILECs in their networks. This is consistent with the decision just rendered by this Commission on August 31, 1999, in Docket No. 971140-TP.

Q. SHOULD THE "FULL MARKET VALUE" OF COMBINATIONS OF NETWORK ELEMENTS BE CONSIDERED IN SETTING PRICES, AS RECOMMENDED BY BELLSOUTH?

A. Absolutely not. First, the market for ubiquitous network facilities is not competitive, but rather it is largely under the control of BellSouth. Thus, the market value of combinations of network elements will not reflect economic costs, as it would if the market were competitive. Instead, the market value for combinations of network elements is artificially inflated by the fact that BellSouth is, by and large, the monopoly provider of ubiquitous network facilities. BellSouth's recommendation, therefore, is tantamount to a request for unrestrained monopoly pricing.

Second, the resulting prices would undoubtedly be discriminatory as the price for a combination of network elements would likely exceed the sum of the prices for the constituent network elements. Also, the price for combinations would most likely exceed the costs – which is BellSouth's internal transfer price -- that BellSouth incurs in providing the same functionalities to itself. To the extent that this is true, prices for combinations, again, would be discriminatory.

Q. DOES THE FCC'S TELRIC COSTING AND PRICING METHODLOGY PRECLUDE CONSIDERATIONS OF "MARKET VALUE?"

A. Yes. BellSouth's proposal here is directly at odds with the FCC's TELRIC costing and pricing methodology. The essence of the FCC's costing and pricing methodology is to set prices at economic costs so as to emulate, by means of regulation, the results of competitive markets in the face of enduring monopoly power. In fact, to curtail the exercise of the ILECs' monopoly power, the FCC explicitly found that the ILECs should not be allowed to consider any forgone profits – or market value – when pricing network facilities for use by dependent competitors, the ALECs. For example, in Rule 51.505(d), *Factors not to be considered*, the FCC explicitly excluded opportunity costs from consideration in pricing network facilities:

(3) *Opportunity costs*. Opportunity costs include the revenues that the incumbent LEC would have received for the sale of telecommunications services, in the absence of competition from telecommunications carriers that purchase elements.

RATES SHOULD BE DEAVERAGED IN ORDER TO REFLECT VARIATIONS IN ECONOMIC COSTS

Q. IS BELLSOUTH OPPOSED TO DEAVERAGING PRICES FOR UNBUNDLED NETWORK ELEMENTS?

A. Yes. On page 26 through 34, BellSouth witness Varner discusses a variety of reasons for why BellSouth objects to deaveraging the prices for unbundled network elements and combinations of unbundled network elements. In essence, Mr. Varner believes that there should be no deaveraging until: (i) "the FCC has completed its 319 proceeding and the list of required UNEs, and associated currently combined UNEs is known"; (ii) "an appropriate universal service funding mechanism [is] implemented in Florida"; and (iii) "BellSouth is able to accomplish some level of rebalancing of its basic local exchange rates."

Q. IS GTE ALSO OPPOSED TO DEAVERAGING UNE RATES IN THIS PROCEEDING?

A. In essence, yes. On page 2 of his testimony, GTE witness Mr. Trimble states:

> My testimony explains that UNE prices *cannot be de-averaged* in a vacuum, because they are inextricably linked to retail prices and universal service support. (Emphasis added.)

Q. IF THE COMMISSION ADOPTS BELLSOUTH's AND GTE's RECOMMENDATIONS, WILL IT BE MANY MORE YEARS BEFORE RATES WILL BE DEAVERAGED?

A. Yes. According to BellSouth's own testimony, "it is unlikely that the Legislature will be able to address the permanent fund much sooner than January 1, 2001." (Varner, page 31.)

Q. DO YOU AGREE WITH BELLSOUTH'S RECOMMENDATION THAT DEAVERAGING BE POSTPONED?

A. No. As I have stated above and in my direct testimony, a number of important policy objectives cannot be accomplished unless prices are set at economic cost, which is TELRIC plus a reasonable allocation of shared and common costs. Most importantly, the development of local exchange competition by means of unbundled network elements – which, at this stage, appears not to be an economically viable proposition in Florida -- will be seriously impaired in the absence of rate deaveraging.

Q. SHOULD THE RATEPAYERS OF FLORIDA BE DEPRIVED OF SIGNIFICANT COMPETITIVE ALTERNATIVES FOR YEARS TO COME?

A. No. Developments in the technology sector, including telecommunications, have been a driving force behind the sustained economic expansion in this country and the State of Florida. Moreover, all indications are that, if anything, telecommunications will play an increasingly important role in the nation's economy. In view of this, the Commission should not permit BellSouth to retard the much needed changes in local exchange markets and turn this state into a telecommunications laggard at the expense of the citizens of Florida.

Q. SHOULD BELLSOUTH'S AND GTE'S ALLEGED CONCERNS OVER UNIVERSAL SERVICE SLOW DOWN THE DEVELOPMENT OF LOCAL EXCHANGE COMPETITION?

A. No. Clearly, the promotion of universal service is an important public policy objective that should always be given careful consideration by the Commission. However, the concerns expressed by BellSouth in no way warrant a delay in the development of local exchange competition.

BellSouth's claims are that deaveraging "without concomitant rate rebalancing ... will ultimately lead to higher prices for rural customers as ALECs usurp the contribution contained in the prices charged in urban areas that currently make lower rural prices possible." (Varner, pages 28-29.)

This "doomsday" scenario assumes a number of unsupported or false claims. First, BellSouth assumes without proof that rural rates are subsidized by urban rates. To demonstrate the veracity of this claim, however, one needs TELRIC data – the very cost data that have not yet been produced by BellSouth. Further, using these TELRIC data, BellSouth would have to demonstrate that other services offered to rural customers, such as vertical features, toll, etc., do not provide sufficient contribution to make serving rural customers, as a class, a profitable proposition.

Second, the argument assumes that there is no growth in telecommunications markets and that its overall profitability will decrease as ALECs make inroads into local markets. BellSouth's and GTE's own experience and that of the industry at large belies this zero revenue and profit growth assumption. Also, developments in the long distance industry have shown that over a period of no less than fifteen years a previously dominant provider, AT&T, can continue to increase its revenues and profits despite the rapid growth of large numbers of competitors. Surely, BellSouth and GTE will continue to be very profitable companies for years to come, even if the Commission does promote local exchange competition – as it should.

Third, BellSouth's "doomsday" scenario assumes that ILECs are unable to compete in urban areas to retain customers. This assumption is also false. ILECs have a variety of ways at their disposal to compete against emerging ALECs: in fact, all the odds appear to be in ILECs' favor. For example, the ILECs can increase their customer responsiveness and marketing and advertising efforts. They can improve their quality of service and availability of services. Last, but not least, the ILECs – even when they are under price cap regulation – have the ability to lower rates. This is certainly true for all services for which the ILECs have pricing flexibility. But, even for basic local rates, the ILECs are not prevented from lowering their rates if they feel that this is needed in order to remain competitive.

Fourth, the Commission has in place a mechanism for BellSouth to seek interim universal service support assistance, if it can justify its request. To date, BellSouth has not sought such relief. More importantly, Sprint, which has already deaveraged its loop prices, as well as transport and switching, has not found it necessary to file for interim USF assistance. It has offered certain deaveraged unbundled network elements since May 20, 1997, the date of Order No. PSC-97-0565-FOF-TP which approved its interconnection agreement with MCI.

In short, by sketching this "doomsday" scenario, the ILECs are manipulating an important policy objective – the promotion of universal service -- to further their own business interest: stave off competition. The

Commission should take care not to be co-opted into becoming the ILECs' unwitting benefactor.

Q. GTE PROPOSES AN ALTERNATIVE PLAN REFERENCED AS THE "DAC." PLEASE DISCUSS GTE'S DAC PROPOSAL.

A. GTE's alternative DAC ("deaveraging adjustment charge") proposal is discussed in the testimonies of Mr. Trimble and Mr. Doane. The proposal is most succinctly summarized, however, on page 24 of Mr. Trimble's testimony. In essence, if the price for a UNE combination that can replicate a business service is less than the retail price for the business service, then the ALEC should pay the ILEC a DAC equal to the difference between the retail price and the price for the UNE combination. Conversely, if the price for a UNE combination that can replicate a residential service is greater than the retail price for the retail service, then the ALEC will receive for the ILEC a DAC equal to the difference between the retail price and the price for the UNE combination.

Mr. Trimble goes on to note that the DAC would be developed on a deaveraged basis.

Q. SHOULD THE COMMISSION ADOPT GTE'S DAC PROPOSAL?

A. No. First, GTE's proposal would result in effective prices for unbundled network elements that deviate quite substantially from economic costs. As I have already demonstrated above and in my direct testimony, economic welfare is diminished when prices deviate from economic costs.

Second, GTE's proposal totally overlooks that there are nonrecurring charges that already raise the costs for ALECs above those incurred by the ILECs. These nonrecurring charges are often the reason for why ALECs have difficulties in finding economically viable uses for unbundled network elements. The last thing this Commission should do, therefore, is to further increase the cost to ALECs for using unbundled network elements.

Third, ILECs have pricing flexibility for a variety of services. Clearly, it would be inappropriate to charge ALECs a DAC based on the presumption that they will be competing against *fixed retail rates*, while in effect, the ILECs often enjoy *pricing flexibility* for the very services that are most likely to encounter competition from the ALECs. The result would be that the economically viable use of unbundled elements by ALECs in competitive situations is greatly reduced, if not eliminated altogether -- an outcome directly at odds with the pro-competitive intent of the Act of 1996.

Fourth, GTE's DAC proposal seems to be a re-incarnation of the efficient component pricing rule ("ECPR"). (See attachments to testimony of GTE witness Mr. Doane.) The essence of the ECPR is that it preserves the profit of the incumbent provider of bottleneck facilities, in this case the ILECs. For this reason, among others, the FCC found that the ECPR should not be used in determining prices for unbundled network elements.

Specifically, in paragraph 709 of its Local Competition Order, the FCC found the following:

> We conclude that the *ECPR is an improper method* for setting prices of interconnection and unbundled network elements because the existing retail prices that would be used to compute incremental opportunity costs under ECPR are not cost based. Moreover, the ECPR does not provide any mechanism for moving prices toward competitive levels; it simply takes prices as given. (Emphasis added.)

Q. HAS THIS COMMISSION ALREADY CONSIDERED AND <u>REJECTED</u> THE ECPR PROPOSAL?

A. Yes. In Order No. PSC-97-0064-FOF-TP (Dockets Nos. 960847-TP and 960980-TP, pages 95-96), the Commission found the following:

> … we have, in Order No. PSC-96-0811-FOF-TP at 17, rejected GTEFL's ECPR as a pricing methodology for unbundled network element rates on the grounds that it eliminates the incentive for competition. In addition, we concur with the FCC's analysis of the ECPR, and its conclusions in paragraph 709 that 'the ECPR does not provide any mechanism for moving prices toward competitive levels; it simply takes prices as given.'

In short, the DAC proposal seems an ill-considered variant of an idea that has already been examined and rejected by regulators. I recommend that the Commission, again, reject GTE's DAC proposal.

RECURRING COSTS AND NONRECURRING COST STUDIES SHOULD BE EXAMINED SIMULTANEOUSLY

Q. DOES GTE ARGUE THAT ILECS SHOULD NOT BE REQUIRED TO FILE NONRECURRING COST STUDIES?

A. Yes. On page 30 of his testimony, GTE witness Mr. Trimble argues that:

> The ILECs should not be required to file nonrecurring cost studies for any individual UNEs or UNE combinations. Most NRCs are affected by OSS wholesale performance measures. The Commission Staff has clarified that OSS issues are not within the scope of this docket.

Q. DO YOU AGREE WITH MR. TRIMBLE'S RECOMMENDATION?

A. No. First, nonrecurring charges continue to form a significant barrier-to-entry, often rendering the use of unbundled network elements uneconomical for ALECs. This is particularly true in regions where turnover is expected to be high and ALECs have only a relatively short time period over which to recoup nonrecurring charges.

Second, there is little evidence that current nonrecurring charges are based on the forward-looking, economic costs of running efficient operational support systems. Any delay in the examination of these nonrecurring charges, therefore, would benefit the ILECs at the expense of the ALECs and, in the final instance, the ratepayers of Florida.

Third, as I have discussed in my direct testimony, it is important to carefully trace costs and to make sure that they are appropriately assigned to either recurring cost categories or nonrecurring cost categories. This task is greatly complicated, however, if the recurring cost studies and nonrecurring cost studies are examined in separate proceedings.

While AT&T and MCI WorldCom agree that the measurement of the performance of the ILECs in providing unbundled network elements is important, such measurements do not have to be in place first to determine the cost-based rates and charges for nonrecurring costs.

In view of these reasons, the Commission should reject GTE's recommendation that nonrecurring costs be ignored Phase II of this proceeding.

Q. DOES GTE ARGUE THAT NONRECURRING COSTS SHOULD BE BASED ON EXISTING OPERATIONS SUPPORT SYSTEMS?

A. Yes. On page 5 of his testimony, GTE witness Mr. Tucek states: "nonrecurring costs associated with ordering UNEs should be based on existing operation support centers."

Q. DO YOU AGREE WITH GTE?

A. No. As I have stated in my direct testimony, nonrecurring cost studies should follow the TELRIC methodology. This means that for purposes of the cost studies, it must be assumed that the ILECs utilize the most efficient electronic systems available. The existing operation support systems are not necessarily consistent with that assumption.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.