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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

JAMES W. SICHTER

Q. Please state your name and business address.

A. My name is James W. Sichter. I am Vice President-Regulatory Policy, for Sprint Corporation. My business address is 4220 Shawnee Mission Parkway, Fairway, Kansas.

Q. Are you the same James W. Sichter who filed Direct Testimony in this proceeding?

A. Yes.

Q. What is the purpose of your Rebuttal Testimony?

A. The purpose of my rebuttal testimony is to address:

1. Mr. Varner's and Mr. Trimble's proposals to delay implementation of deaveraging.

2. Mr. Varner's, Dr. Emmerson's, and Mr. Trimble's proposals to encumber the pricing of UNEs and UNE combinations with considerations that are both inappropriate and inconsistent with the FCC's UNE pricing rules, in particular Section 51.505(d).

3. Mr. Varner's and Mr. Trimble's interpretation of "currently combined" as it applies to UNE combinations that must be provided by ILECs.

4. The specific deaveraging recommendations of witnesses Hendrix, Trimble, Barta, Gillan and Strow.

Q. What reasons do Mr. Varner and Mr. Timble give for delaying implementing the FCC's UNE deaveraging rules?

A. Mr. Varner argues (page 40, lines 3-5) that "...geographic deaveraging of UNEs should not be considered until the Commission addresses the issues of funding for universal service and rate rebalancing and the FCC concludes its 319 proceeding". He further suggests (page 31, lines 20-21) that the Commission seek a waiver of the FCC's rule requiring UNE deaveraging. Mr. Trimble (page 24, lines 1-5) would also support a waiver.

Q. Is it necessary or appropriate for the Commission to defer action in this proceeding pending the completion of the FCC's 319 proceeding?

A. No. The Commission should proceed using the working assumption that the list of UNEs previously adopted by the FCC will be reaffirmed. Since the FCC is expected to issue an order in its 319 proceeding within the next several weeks, any additions or deletions to the list of UNEs can be quickly incorporated into this proceeding. As the Commission is well aware, the FCC has stayed its UNE deaveraging rules only until six months after it issues a decision in its Universal Service proceeding. Therefore, it is necessary and appropriate for the Commission to expeditiously move to define its UNE deaveraging rules to comply with the FCC's deadline.

Q. In his prefiled direct testimony, BellSouth's witness Varner (and others) contends that this Commission should, in light of the FCC's 319 proceeding, consider the "necessary" and "impair" standards for individual UNEs before addressing deaveraging UNE prices. Do you agree?

A. Absolutely not. Mr. Varner's contention is a "red herring" which, if followed, would only serve BellSouth's ultimate goal: to delay this Commission deaveraging UNE prices. The U.S. Supreme Court clearly stated that it is the FCC, and not the individual states, that has the

authority to interpret the "necessary" and "impair" requirements of the Telecom Act.

What Mr. Varner urges is that this Commission prejudge the outcome of the FCC's 319 proceeding: first, by presuming that the FCC will adopt, without modification, BellSouth's interpretation of the "necessary" and "impair" standards; and, second, by presuming the FCC will also then delegate to the individual states the authority to apply those standards. Based on these presumptions, Mr. Varner would then have the Commission transform this proceeding on UNE rate deaveraging into a 319 "necessary" and "impair" proceeding.

While Mr. Varner may believe that BellSouth's position on the "necessary" and "impair" standards is compelling, a great many other parties, including Sprint, have set forth interpretations that would achieve a quite different result than BellSouth's. But replicating the arguments that have been made in the FCC's 319 proceeding would serve no useful purpose in this proceeding since it is the FCC, and not this Commission, that ultimately will make the determination of the "necessary" and "impair" standards. To engage in such an exercise would be not only wasteful, but would also distract the Commission from focusing on the central purpose of this proceeding--the deaveraging of UNEs.

The FCC has announced its intention to render a decision in its 319 proceeding in its September 15, 1999 Open Meeting. As I stated above, any modifications to the list of UNEs resulting from the FCC's decision can be incorporated into this Commission's UNE deaveraging proceeding.

Q. Are not Mr. Varner's and Mr. Trimble's concerns about uneconomic arbitrage legitimate? If so, why shouldn't the Commission delay UNE deaveraging until it also addresses rate rebalancing and universal service?

A. Sprint fully recognizes the need to synchronize retail rates, UNE rates, and universal service, and that the failure to do so will open up opportunities for uneconomic arbitrage. However, Sprint does not agree that the proper course of action is to simply defer action on UNE deaveraging until retail rates are rebalanced and universal service funding is implemented.

In the first place, as I discussed in my direct testimony, there is no question that UNE deaveraging is required by the Telecom Act of 1996 and the FCC Rules implementing that Act. The purpose of the FCC's stay of its deaveraging rules was intended to give states time to sort through and rationalize the relationship between retail rates, UNE rates, and universal service. Sprint would certainly support Commission initiatives that do just that. But that should in no way impede the development and

implementation of cost-based, deaveraged UNEs as required by the Act and the FCC's Rules.

The development of deaveraged UNEs is in fact the necessary first step in developing both retail rate deaveraging and universal service plans. Again, cost-based UNEs are a requirement of the Telecom Act. Only once those deaveraged UNE rates are established can the Commission make a determination of the appropriate level of retail rate rebalancing and universal service funding to bring retail prices into a consistent economic relationship to UNE prices.

Second, while Sprint recognizes that it is probably not possible for this Commission to simultaneously implement UNE deaveraging, retail rate rebalancing, and universal service and still meet the FCC's deadline for UNE deaveraging, the Commission should be highly skeptical of allegations that implementing UNE deaveraging alone will inflict material adverse economic harm on either ILECs or the competitive marketplace. Sprint-Florida's actual experience suggests that deaveraging UNEs without addressing other related issues does not necessarily lead to immediate and widespread arbitrage. Sprint-Florida has offered deaveraged loop and local switching UNEs for almost a year. Yet, CLECs have not moved to exploit these deaveraged UNEs to any great degree. Sprint-Florida's experience suggests that CLECs' business strategies are not geared just to exploit arbitrage opportunities, but rather are based

on longer term considerations. Indeed, Sprint's own CLEC's strategy fully recognizes that any such uneconomic arbitrage opportunities are short-term, and accords them little weight in their overall business plans.

This emphatically should not be taken to mean that Sprint-Florida believes that the economic inconsistency between its retail rates and UNE rates should or can be maintained indefinitely. While we recognize that legislative action will be required to enable the Commission to undertake the requisite rate rebalancing and universal service measures to bring retail rates into consistency with deaveraged, cost-based UNEs, this does not relieve the Commission of its obligations under the Act and the FCC's Rules to proceed with the implementation of deaveraged UNEs.

Third, the Commission should place no confidence in Mr. Varner's and Mr. Trimble's apparent belief that a petition for waiver of the UNE deaveraging would be granted. Clearly, the FCC itself believes that the stay provides sufficient time for a state to address any concerns related to UNE deaveraging (Stay Order, Docket 96-98, released May 7, 1999, para. 5). Simply relying on the theoretical concerns expressed by the BellSouth and GTE witnesses is hardly a compelling case for a waiver. Moreover, the FCC's statements regarding the possibility of waivers can in no way be construed to indicate they would be sympathetic to a waiver to defer altogether implementation of deaveraging. Rather, the FCC specifically referenced the potential for a waiver (Stay Order, para 7) in

the context of the example of a state making a finding that two zones, rather than three, would be sufficient. The FCC, in other words, fully expects states to undertake a proceeding precisely like the instant proceeding in order to factually establish any basis for deviating from the existing UNE deaveraging rules.

Q. You also reference proposals that would "...encumber the pricing of UNEs and UNE combinations with considerations that are both inappropriate and inconsistent with the FCC's UNE pricing rules, in particular Section 51.505(d)." Please describe the pricing rules contained in Section 51.505(d) of the FCC's Rules.

A. Section 51.505 contains the FCC's Rules for defining forward-looking economic costs. In particular, in Section 51.505(d) the FCC also explicitly addresses what types of costs are not included in its definition of forward-looking economic costs. This section of the rules was adopted in response to arguments made by incumbent LECs that UNE pricing should reflect factors other than forward-looking economic costs, many of which arguments are being recycled in this proceeding by the BellSouth and GTE witnesses. Section 51.505(d) reads as follows:

(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.

(2) Retail costs. Retail costs include the costs of marketing, billing, collection, and other costs associated with offering retail telecommunications services to subscribers who are not telecommunications carriers...

(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.

(4) Revenues to subsidize other services. Revenues to subsidize other services include revenues associated with elements of or telecommunications service offerings other than the element for which a rate is being established.

Q. Mr. Trimble proposes that one of the guidelines for deaveraging UNEs should be that "...they are consistent with retail rate structures and levels (i.e., eliminate the uneconomic arbitrage of the ILECs' rate structures)" (page 17, lines 24-25, page 18, line 1). He further proposes that the Commission consider a "deaveraging adjustment charge" (DAC) as one means to accomplish that objective (page 24, lines 9-13). Similarly, Dr. Emmerson (page 23, lines 2-4) contends that "...the prices of retail services are critically relevant to determining the market prices of

unbundled network elements." Mr. Varner also argues that UNE prices need to be "...established in appropriate relationship to existing services." (page 22, lines 19-20).

Q. Is it appropriate, and consistent with the Telecom Act and the FCC Rules, for this Commission to consider retail rate levels and structures in determining UNE rates, including deaveraged UNE rates?

A. Absolutely not. These proposals to conform UNE pricing to existing retail rate structures and levels reflect a fundamental--and disturbing-misunderstanding of the very purpose of the Telecommunications Act of 1996. Clearly, an overriding objective of the Act is to promote competition in all telecommunications markets. Inexorably, competition will, and should, drive prices toward costs. Rather than accede to this basic principle, these witnesses propose to stand the Telecom Act on its head by advocating measures intended to sustain pricing inefficiencies that are the legacy of a monopoly environment.

As discussed above, Sprint fully recognizes the need to eliminate the potential for uneconomic arbitrage. However, that objective must be accomplished in a manner consistent with the Telecom Act, and the Telecom Act provides a framework for addressing the concerns of the BellSouth and GTE witnesses. While the Act requires cost-based pricing for UNEs, Congress also recognized that universal service has historically

been funded through implicit subsidies in ILEC rates. Therefore, Section 254 of the Act provides for the replacement of those implicit subsidies by an explicit universal service fund. In conformance with the dictates of the Act and the objective of promoting competition and economic efficiency, the Commission should set UNE rates at cost levels, and then rebalance retail rates consistent with economic costs. To the extent rate rebalancing jeopardizes universal service, any subsidies needed to maintain universal service should be provided through an explicit, competitively neutral universal service fund.

Furthermore, the FCC has explicitly considered and rejected the approach advocated by the BellSouth and GTE witnesses. Section 51.505(d)(3) precludes the incorporation of opportunity costs (i.e., loss of retail revenues) in setting UNE prices. Even more, the FCC considered and rejected the "Efficient Component Pricing Rule" (ECPR), a version of which is proposed by Mr. Trimble and Mr. Doane. In its First Report and order in Docket 96-98, released August 8, 1998, paragraph 709, the FCC stated "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...application of ECPR would result in input prices that would be either higher or lower than those which would be generated in a competitive market and would not lead to efficient retail pricing."

In paragraph 710 of that Order, the FCC further concluded "While the ECPR establishes conditions for efficient entry given existing retail prices, as its advocates contend, the ECPR provides no mechanism that will force retail prices to their competitive levels. We do not believe that Congress envisioned a pricing methodology for interconnection and network elements that would insulate incumbent LECs' retail prices from competition."

Q. Mr. Varner states that "The FCC does not currently have any pricing rules applicable to combinations of UNEs" (page 22, lines 10-11). He goes on to conclude that "The Commission has the latitude to price currently combined UNEs at market levels because such pricing is allowed by the Act and it does not conflict with the FCC's pricing rules." (page 39, lines 1-3). Is Mr. Varner correct?

A. No. Mr. Varner overlooks the obvious: the FCC did not promulgate specific rules for the pricing of combinations of UNEs because to have done so would have been redundant. The appropriate price for combined UNEs, as I state in my direct testimony, is simply the forward-looking economic costs of the UNEs contained in that combination--i.e., the cost basis for UNE combinations is the same as the cost basis for individual UNEs. Technically, the appropriate price for a UNE combination is not always simply the sum of the prices for the individual UNEs in that

combination. In some instances, the costs included in the price of one UNE are also included in the price of another UNE when either is purchased separately. An example is the Main Distribution Frame (MDF) which is included in the costs of both local switching and loops. When those two elements are bought in combination, simply adding the prices of the two elements would result in double recovery of MDF costs.

Therefore, the price of the UNE combination would need to be somewhat less than the sum of the prices of the individual UNEs.

Rather, Mr. Varner would have the Commission believe that the FCC either "forgot" to issue pricing rules for combined UNEs or else intended to provide some unspecified degree of flexibility to states to price UNE combinations differently than individual UNEs. The possibility that the FCC overlooked as important an issue as the pricing of UNE combinations is ludicrous. Any contention that the FCC envisioned pricing combined UNEs at levels other than forward-looking economic costs is totally unsupported and inconsistent with the FCC's decision in Docket 96-98 and its accompanying rules.

In the first instance, Mr. Varner's policy rationale for pricing UNE combinations at "market" rates appears to be that cost-based pricing of UNE combinations would undermine retail rates (page 39, lines 8-21). (Mr. Varner also erroneously attempts to bootstrap a Commission

decision interpreting the interconnection agreement between BellSouth and MCIm into a conclusion that the Commission determined that UNE combinations that recreate an existing retail service should not be based on the sum of the individual UNE prices).

As discussed in detail above, incorporating consideration of retail revenues into the pricing of UNEs is prohibited by Section 51.505(d)(3) of the FCC's Rules. Moreover, the FCC's First report and Order in Docket 96-98 is not altogether silent on the issue of pricing UNE combinations. In discussing the differences between resale and UNE combinations the FCC notes, in paragraph 334, that "A carrier purchasing unbundled network elements must pay for the cost of that facility, pursuant to the terms and conditions agreed to in negotiations or ordered by states in arbitrations." In the footnote to that sentence, the FCC references Section VII (Pricing of Interconnection and unbundled Elements) of its Order, "...describing the terms under which new entrants will pay for the cost of unbundled elements." If the FCC had any intention of permitting the pricing of UNE combinations to be anything other than the sum of the individual UNE prices, it would have so stated. Rather, it simply referenced that section of its Order that required UNE prices to be based only on costs.

Further support for Sprint's position that prices for UNE combinations should be based only on costs is provided by the FCC's discussion of the

requirement set forth in Section 252(d)(1)(A)(ii) of the Telecommunications Act that rates for unbundled network elements shall be "nondiscriminatory". In paragraph 860 of its First Report and Order in Docket 96-98, the FCC concluded that rate differences that reflect differences in costs are not discriminatory. The FCC further found that "On the other hand, price differences based not on cost differences but on such considerations as competitive relationships, the technology used by the requesting carrier, the nature of the service the requesting carrier provides, or other factors not reflecting costs, the requirements of the Act, or applicable rules, would be discriminatory and not permissible under the new standard." (para. 861).

Mr. Varner does not claim that there exist cost differences between a UNE combination and the costs of the UNEs contained in that combination. Nor does he cite any "requirements of the Act or applicable rules" that would justify deviation from cost-based pricing for UNE combinations. Consequently, his proposal to price UNE combinations at a level other than the sum of the prices of the individual UNEs violates the Act's mandate that prices for UNEs be nondiscriminatory.

Q. Mr. Varner (page 35, lines 3-8) and Mr. Trimble (page 28, lines 8-11) propose that "currently combined" network elements be construed to mean only those elements that are actually already physically combined for an existing customer that a CLEC desires to serve, and that an ILEC

has no obligation to combine elements for customers who currently are not already provided service using those combined elements. Do you agree with their interpretation of the FCC's Rules?

A. No. As stated in my direct testimony, the term "currently combined" should be interpreted as "ordinarily combined", and ILECs should be required to provide requesting carriers any combinations that the ILEC itself offers, through its wholesale (e.g., access) or retail tariffs, to combine. For instance, ILECs combine the loop, port, local switching, and transport in providing basic local exchange service. There exists no technical reason why an ILEC could not, or should not, combine those same elements when provided as UNEs to a CLEC.

Nor, by the very terms of their own argument, can BellSouth or GTE deny that they have the obligation, at the request of the CLEC, to combine elements ordinarily combined in their network. Both BellSouth and GTE concede, as they must, that they have the obligation to provide combined UNEs if those UNEs are already combined in the service provided to a specific customer whom the CLEC desires to serve.

For new customers, or customers whom a CLEC desires to serve using elements not already combined in that customer's existing service configuration, BellSouth and GTE would refuse to directly combine elements to enable the CLEC to serve that customer. This, however, does

not end the matter. CLECs could still obtain the UNE combination. One alternative, of course, would be for the customer to first order the service from the ILEC, which would "combine" the elements in providing the service. At that point, a CLEC could then obtain that UNE combination for that particular customer since it would then be "currently combined" in the ILEC network. A second alternative would be for the CLEC to provide service to that customer through resale. Once again, the ILEC would "combine" the elements to provide the resold service. And, the elements having been combined, the CLEC could convert the "as is" or "currently combined" elements from resale to a UNE combination.

In other words, denying CLECs the ability to directly obtain combined UNEs for customers for whom the ILEC does not currently combine those elements does not mean that the CLEC cannot ultimately obtain that UNE combination for that specific customer. The only requirement is that the ILEC itself combines those UNEs in providing the tariffed service to that customer.

Of course, BellSouth's Varner (page 37, lines 17-19) also graciously offers that "...BellSouth is willing to perform this function upon execution of a commercial agreement that is not subject to the 1996 Act."--i.e., at above cost rates.

The sole result of the BellSouth and GTE interpretation of "currently combined" is to impose delay, inconvenience, and additional costs on CLECs in obtaining UNE combinations. Their refusal to directly combine, at the request of CLECs, UNEs ordinarily combined in providing their own retail and wholesale tariffed services serves no function other than to deter competitive entry.

Q. Mr. Varner contends that "The FCC's view of currently combined is the same as BellSouth's view" (page 35, line 10). Is that correct?

A. No. Certainly, the FCC, in the quote from its brief before the Supreme Court, strongly urged the view that ILECs cannot physically disconnect already combined elements unless requested to do so by the ordering CLEC. The context of that argument was to argue against ILEC contentions that the unbundling provisions of the Act require that ILECs physically separate already combined elements. Not addressed, because it was irrelevant to the issues at hand, was the ILECs' obligation to combine elements that were not already combined. The FCC's statement, however, cannot be construed to also mean that the FCC does not believe that ILECs have no obligation to combine elements at the request of a CLEC. Again, as discussed in my direct testimony and in answer to the preceding question, it is reasonable to interpret the FCC's rules to require that ILECs combine elements that are "ordinarily combined" in their network.

Even more, it is impossible to credit the FCC with endorsing the contorted and blatantly anti-competitive interpretation of the Act offered by BellSouth and GTE. The very reasoning put forth by the FCC in its Supreme Court brief is equally applicable to BellSouth's and GTE's current interpretation of their obligations: what they are seeking to do, for no "productive reason", is to impose "wasteful"costs on new entrants.

Q. You also expressed concerns regarding the specific deaveraging recommendations of a number of witnesses. Please explain.

A. A number of witnesses make recommendations regarding what elements should be deaveraged, into how many zones, and how those zones should be defined. For example, Mr. Hendrix (page 6, lines 4-9) recommends deaveraging loops into only two zones, based on existing retail tariff rate groups. Mr. Trimble (page 9, lines 20-25, page 10, lines 1-12) contends that switching and transport UNEs should not be deaveraged. Mr. Barta (page 6 lines 15-17) advocates three zones for unbundled loops. Mr. Gillan (page 4, lines 1-4) urges the Commission to deaverage loops only in this proceeding, and address the deaveraging of other elements in future proceedings. Ms. Strow (page 7, lines 13-15) advocates three zones for UNEs, and that ILECs should use the same zones they use for deaveraging interstate special access services.

Sprint recommends that the Commission not prejudge what elements should be deaveraged, the number of zones, and the manner in which zones are defined. Rather, the Commission should first undertake to develop an empirical record on geographic cost variations, and only then make those types of determinations. Clearly, the cost data presented in the testimony of Sprint witness Dickerson indicates that the costs of loops, transport, and local switching usage vary significantly by geography. That same data also strongly supports the notion that more than three zones would be appropriate. Moreover, the geographic variation in costs differs by element. While, to take one example, the existing zones used for deaveraging interstate special access might be appropriate for deaveraging transport, those same zones would not necessarily be appropriate for deaveraging loops.

Q. Mr. Barta (page 7, lines 11-14) expresses concerns that deaveraging would provide ILECs with "excessive pricing flexibility and the ability to shift costs from competitive markets to less competitive markets." Is that concern warranted?

A. Not if deaveraging is based solely on costs. As I have discussed in my direct testimony, the Act requires cost-based pricing. And, indeed, cost-based pricing of UNEs is critical in providing new entrants the appropriate pricing signals for making their investment and entry decisions.

Q. Does that conclude your rebuttal testimony?

A. Yes.