

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Pricing Proceeding ) DOCKET NO. UT-960369  
for Interconnection, Unbundled )  
Elements, Transport and Termination, )  
and Resale )  
)

In the Matter of the Pricing Proceeding ) DOCKET NO. UT-960370  
for Interconnection, Unbundled )  
Elements, Transport and Termination, )  
and Resale for U S WEST )  
COMMUNICATIONS, INC. )

In the Matter of the Pricing Proceeding ) DOCKET NO. UT-960371  
for Interconnection, Unbundled )  
Elemetns, Transport and Termination, )  
and Resale for GTE NORTHWEST )  
INCORPORATED )

DIRECT TESTIMONY

OF

DONALD C. EACHUS

RECEIVED  
PROGRAM MANAGEMENT  
97 MAR 29 PM 2:29  
STATE OF WASH  
UTIL. AND TRANSP.  
COMMISSION

March 27, 1997

WUTC DOCKET NO. UT 960369  
EXHIBIT NO. (T) 182

ADMIT  W/D  REJECT

SEE (T) C-182 FOR ATTACHMENTS

**GTE NORTHWEST INCORPORATED**

**DIRECT TESTIMONY OF**

**DONALD C. EACHUS**

**WUTC UT-960369, 960370, 960371**

**I. Introduction**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 A. My name is Donald C. Eachus. My business address is One GTE Place,  
3 Thousand Oaks, California.

4 **Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?**

5 A. I am employed by GTE Telephone Operations, as Section Manager - Costing. In  
6 this proceeding I am providing testimony on behalf of GTE Northwest  
7 Incorporated ("GTE" or "the Company").

8 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND AND**  
9 **EXPERIENCE IN THE TELECOMMUNICATIONS INDUSTRY.**

10 A. I graduated from California State University, Northridge, California in 1982 with a  
11 Bachelor of Science degree in Corporate Finance.

12 I was employed by General Telephone Company of California, now  
13 GTE California Incorporated, in 1982 and held various positions in the Finance  
14 organization. In 1989, I was named Staff Administrator - Regulatory Accounting  
15 for GTE Telephone Operations, and in 1991 I was promoted to the position of  
16 Staff Manager - Regulatory Planning and Management. In both positions, my

responsibilities involved development, support and advocacy of regulatory activities for the West Area.

In February 1996, I was named Section Manager - Costing in the Pricing and Tariffs organization.

**Q. WHAT ARE THE RESPONSIBILITIES OF YOUR CURRENT POSITION?**

A. As Section Manager - Costing, I am responsible for the development and implementation of pricing and costing policy and procedures; the design of corresponding price structures for toll and local network service offerings; and the design and execution of cost studies necessary to support certain pricing proposals. I also assist in the development of tariffs for these services according to state commission rules and regulations.

I am responsible for these activities in California, Arizona, Nevada, and in other states as the need may arise from time to time.

**Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION OR ANY OTHER REGULATORY COMMISSIONS?**

A. I have previously appeared before the state regulatory commissions in California, Hawaii and Michigan.

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

A. My testimony describes the methodology, assumptions and results of GTE's avoided cost analysis, which the Commission should approve for use in Phase 2 of this proceeding to set the wholesale discounts that will apply to GTE's retail telecommunications services made available for resale. A copy of GTE's avoided cost study, which I described at the first workshop in this proceeding, is

attached to my testimony.

2 **Q. PLEASE SUMMARIZE YOUR TESTIMONY?**

3 A. GTE presents an avoided cost study which satisfies the requirements of the  
4 Telecommunications Act of 1996. It should be utilized by the Commission to set  
5 wholesale discounts for the retail services purchased by resellers. GTE's  
6 Avoided Cost Study continues to use the "avoided cost" standard mandated by  
7 the Act in producing an avoided cost discount of 12.87%.

8 GTE's Avoided Cost Study removes the net avoided cost reflecting the  
9 fact that while retail costs are avoided, GTE will incur some similar activity in  
10 offering the same service on a wholesale basis. Direct expenses were first  
11 adjusted to remove costs which are not avoided such as Carrier Access expense  
and Public Telephone expense. Expenses associated with retail service order  
13 activity are not avoided because worktime and process requirements will be  
14 more extensive for resale. GTE's avoided cost study then analyzed the  
15 remaining costs at a sub-ARMIS account level to determine the percent of direct  
16 expenses avoided.

17 GTE's Avoided Cost Study includes indirect, or shared, costs in the  
18 calculation of the avoided cost discount. Indirect avoided expenses were  
19 calculated following the FCC approach of utilizing the ratio of avoided direct  
20 expense to total expenses. Uncollectibles were considered largely, but not  
21 entirely, avoided. The resulting total avoided costs were divided by total  
22 revenues for all services offered for resale at wholesale rates to generate the  
avoided cost discount rate of 12.87%

**Q. HOW IS YOUR TESTIMONY ORGANIZED?**

A. Section II of my testimony discusses the cost study assumptions that are appropriate for any avoided cost study, and the appropriate treatment of specific categories of costs in such a study. Section III discusses GTE's methodology and the study model used to calculate an aggregate avoided cost discount rate to be applied uniformly to all services offered for resale at wholesale rates.

**Q. WHY DID GTE PERFORM AN AVOIDED COST STUDY?**

A. The Telecommunications Act of 1996 (the Act) states that it is the duty of each incumbent local exchange carrier (ILEC) "to offer for resale at wholesale rates any telecommunications service that the carrier provides at retail to subscribers who are not telecommunications carriers." 47 U.S.C. § 251(c)(4) (1996). The Act further states that for this purpose "a State commission shall determine wholesale rates on the basis of retail rates charged to subscribers for the telecommunications service requested, excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier." 47 U.S.C. § 252(d)(3) (1996). Therefore, an avoided cost study is necessary to satisfy the requirements of the Act.

The avoided cost study filed by GTE in this proceeding addresses various concerns raised by the Commission during the arbitration proceedings and is, for that reason, different from the Original Avoided Cost Study GTE presented during the arbitration. GTE's fundamental costing assumptions, however, remain the same. For example, GTE continues to use the "avoided" cost standard mandated by the Act, rather than the "avoidable" cost standard

advocated by various CLECs.

2 **Q. PLEASE SUMMARIZE THE RESULTS OF GTE'S AVOIDED COST STUDY.**

3 A. GTE's Avoided Cost Study filed in this proceeding produces a single discount  
4 rate to be applied uniformly to all services offered for resale at wholesale rates,  
5 based on GTE's own state-specific costs. Based on this study, the appropriate  
6 avoided cost discount rate is 12.87% for GTE's operations throughout the state  
7 of Washington.

## 8 **II. Avoided Cost Study Principles**

### 9 **A. Avoided Cost Standard**

10 **Q. WHAT IS THE APPROPRIATE AVOIDED COST STANDARD?**

11 A. GTE maintains that the appropriate standard for any avoided cost study is the  
12 "avoided cost" standard clearly mandated by the Act, as opposed to the  
13 "avoidable cost" standard which was substituted by the FCC in its First Report  
14 and Order released August 8, 1996 (the Order). This standard ensures that the  
15 avoided cost study properly evaluates those costs that "will be avoided" when  
16 services are offered for resale at wholesale rates.

17 **Q. SOME HAVE ARGUED THAT THE ACT ADDRESSES "COSTS THAT WILL  
18 BE AVOIDED" WITHOUT PLACING ANY LIMITATION ON THE FUTURE  
19 TIME INTERVAL FOR EVALUATING AVOIDED COSTS. IS THIS  
20 CONSISTENT WITH YOUR READING OF THE ACT?**

21 A. No, not at all. I believe the emphasis on "future time interval" is entirely  
22 misplaced. As I read it, what this part of the Act requires is the identification of  
23 those costs that are certain to be avoided (*i.e., will be avoided*) when services

are offered for resale at wholesale rates. The central issue is not the timing, but rather the certainty, of cost avoidance.

Clearly, the appropriate time interval over which to evaluate avoided costs is the interval during which the associated wholesale prices will be in effect. If costs will not actually be avoided during that time interval, then they should not be included as avoided in the avoided cost study; otherwise the wholesale prices that are set based on that study will not be compensatory.

**Q. DO YOU AGREE WITH THE FCC'S STATEMENT THAT "AVOIDED COSTS ARE THOSE THAT AN INCUMBENT LEC WOULD NO LONGER INCUR IF IT WERE TO CEASE RETAIL OPERATIONS"?**

A. No. In contrast to the FCC's analysis, GTE's study does not assume that GTE will cease retail operations. It is patently unrealistic to assume that GTE will be driven to exit the retail services market entirely. A model that assumes GTE will exit entirely from the retail services market will lead to faulty assumptions about the kind and amount of costs that GTE can reasonably be expected to be avoided when part of its current retail product offering is provisioned instead on a wholesale basis for resale.

**Q. CAN YOU GIVE AN EXAMPLE OF HOW THE "EXIT RETAIL" MODEL WILL LEAD TO FAULTY STUDY ASSUMPTIONS ABOUT AVOIDED COSTS?**

A. Yes. Product management, USOA Account 6611, includes costs incurred in performing administrative activities related to marketing products and services. This includes competitive analysis, product and service identification and specification, test market planning, demand forecasting, product life cycle

analysis, pricing analysis, and identification and establishment of distribution channels.

If GTE were to exit the retail market entirely for all products, I would expect retail product management activities to cease entirely, and those activities would be performed instead by resellers. But this is not what is actually happening. As discussed later in my testimony, product management activities will continue to be performed by GTE, and conversely will not be performed by a reseller who purchases services GTE has already developed ready for resale.

**B. Definition of Avoided Costs**

**Q. HOW ARE AVOIDED COSTS DEFINED FOR THE PURPOSES OF THE GTE AVOIDED COST STUDY?**

A. Avoided costs are defined as the difference in total costs with and without the offering of services for resale, *i.e.*, those marketing, billing, collection and other costs that *will be avoided* when a service is offered through wholesale, rather than retail, distribution channels. Resale is defined as the sale of services to a reseller for sale, without change in the nature of the product, to the reseller's end-user customer.

**Q. WHAT IS THE BASIS FOR THIS DEFINITION OF AVOIDED COSTS?**

A. This definition is based directly on the resale requirements as defined under the Act. 47 U.S.C. § 252(d)(3) (1996). This definition also acknowledges the fact that while some retail costs are avoided for certain activities, a similar activity is often required to offer the same service on a wholesale basis for resale. For



example, retail customer billing activities may be avoided when the service is offered instead for resale, but a wholesale billing function must still be performed; the avoided cost of billing is, by definition, the net difference between the costs of these activities. Said another way, the cost of the new wholesale billing function is properly attributed to the service being offered for resale, and recovered through the wholesale price.

An avoided cost study should include indirect, or shared, costs as well as direct costs, based on the rationale that "indirect or shared costs, such as general overheads, *support all of the LEC's functions.*" Order at ¶ 912 (emphasis added).

**Q. WHAT "DIRECT" EXPENSES SHOULD BE INCLUDED AS AVOIDED COSTS?**

A. Avoided costs should include as direct costs those marketing and services expenses reported in ARMIS accounts 6611, 6612, 6613, 6621, 6622 and 6623 that will be avoided. Order at ¶917, and 47 C.F.R. § 51.609(c)(1) and (d).

Avoided costs should also include as direct costs any expenses reported in ARMIS accounts 6110-6116 and 6210-6565 that can be directly identified as, and proven to be, costs that will be avoided. 47 C.F.R. § 51.609(c)(3) and (d).

**Q. WHAT "INDIRECT" EXPENSES SHOULD BE INCLUDED AS AVOIDED COSTS?**

A. Avoided costs should include as indirect costs a portion of general support and overhead expenses indirectly attributable to the support or administration of activities represented by the avoided direct expenses; these expenses are reported in ARMIS accounts 6121-6124, 6711-6712 and 6721-6728. Order at

¶¶912 and 918, and 47 C.F.R. § 51.609(c)(2).

2 **Q. ARE THERE ANY SPECIAL CONSIDERATIONS WHICH MUST BE KEPT IN**  
3 **MIND WHEN USING ARMIS ACCOUNTS TO DETERMINE AVOIDED COSTS**  
4 **FOR PURPOSES OF THE WHOLESALE DISCOUNT?**

5 A. Yes. ARMIS accounts were not designed for the purpose of identifying avoided  
6 costs. Consequently, they do not contain just retail costs. These accounts also  
7 contain costs for services which are not subject to the resale requirement under  
8 the Act. For example, costs for existing wholesale functions are commingled  
9 with the cost to provide retail services. These costs must first be culled from the  
10 amounts in the ARMIS accounts before those accounts can be used to  
11 determine the level of avoided costs.

**C. Product Management**

13 **Q. ARE PRODUCT MANAGEMENT EXPENSES AVOIDED WHEN**  
14 **SERVICES ARE OFFERED FOR RESALE AT WHOLESALE RATES?**

15 A. Expenses in the Product Management account are not avoided in their entirety  
16 when services are offered for resale at wholesale rates. In fact, product  
17 management expenses are generally not avoided when retail services are  
18 available for resale.

19 An analysis of specific work functions and activities is necessary to  
20 identify the costs that will be avoided.

21 **Q. WHY DO YOU CLAIM THAT PRODUCT MANAGEMENT EXPENSES ARE**  
22 **GENERALLY NOT AVOIDED?**

23 A. Product management expenses are generally not avoided, since product

1 planning, product development and product roll out activities, which account for  
2 the preponderance of expenses recorded in this account, are required  
3 regardless of whether the products are offered at retail or wholesale. This  
4 assertion is further proven simply by observing that the reseller incurs none of  
5 these types of expenses, and so to the extent that product planning,  
6 development and introduction occurs, the associated costs will continue to be  
7 borne by GTE and will not be avoided.

8 **Q. WHAT WOULD BE THE IMPACT OF TREATING THESE EXPENSES AS**  
9 **AVOIDED?**

10 A. Treating product management expenses as avoided will competitively  
11 disadvantage the ILEC. ILEC retail customers would pay for all of the expenses  
12 and reseller's customers would pay for none of the expenses. If product  
13 management expenses were considered avoided then no new product offerings  
14 would be made to the retail or resale customer; no pricing, tariffing, costing or  
15 forecasting functions for resold services would occur; and current product life  
16 cycle management for existing services available for resale would cease to exist.  
17 This is clearly not a realistic assumption. In addition, included in the Product  
18 Management account are significant expenses related to GTE's Carrier Access  
19 line of business which is not available for resale and the associated expenses  
20 are not included in the retail rates for services that are offered for resale.

21 **D. Sales**

22 **Q. ARE "SALES" EXPENSES AVOIDED WHEN SERVICES ARE OFFERED FOR**  
23 **RESALE AT WHOLESALE RATES?**

1 A. No. Expenses recorded by ARMIS as "Sales expenses" are not avoided in their  
2 entirety when services are offered for resale at wholesale rates. Certain sales  
3 expenses associated with the provision of GTE's switched and special access to  
4 interexchange carriers should not be treated as avoided.

5 An analysis of specific work functions and activities is necessary to  
6 identify the costs that will be avoided.

7 E. Advertising

8 **Q. ARE ADVERTISING EXPENSES AVOIDED WHEN SERVICES ARE OFFERED**  
9 **FOR RESALE AT WHOLESALE RATES?**

10 A. Advertising expenses are not avoided in their entirety when services are offered  
11 for resale at wholesale rates. Corporate name recognition advertising expenses  
not product related cannot be considered as avoided.

13 An analysis of specific work functions and activities is necessary to  
14 identify the costs that will be avoided.

15 F. Operator Services

16 **Q. IN THE ARBITRATIONS, GTE'S COMPETITORS CLAIMED THAT OPERATOR**  
17 **SERVICES AND DIRECTORY ASSISTANCE SERVICES ARE AVOIDED WHEN**  
18 **DETERMINING THE WHOLESALE DISCOUNT. IS THIS A CORRECT**  
19 **APPLICATION OF THE ACT?**

20 A. No; it violates the requirement that a cost must be included in the retail rate in  
21 the first place before it can be deemed avoided for purposes of calculating the  
22 discount.

23 **Q. HOW DOES THE COMPETITORS' POSITION VIOLATE THE REQUIREMENT**

2           **THAT A COST BE COVERED BY THE RETAIL RATE BEFORE IT CAN BE**  
3           **CONSIDERED "AVOIDED"?**

4           A.    It violates this element of the Act. The cost of operator and directory assistance  
5           services are not covered by the retail rate for local service. Rather, Operator  
6           services have their own rates, which cover their costs. Therefore, the expenses  
7           associated with Operator services are not included in the rates for other retail  
8           services offered for resale. Hence, AT&T will avoid paying the tariffed rates for  
9           Operator services if it elects to provide its own operator services and not  
10          subscribe to those offered by GTE.

11          **Q.    HOW DOES GTE PROPOSE TO OFFER OPERATOR SERVICES IN A**  
12          **RESALE ENVIRONMENT?**

13          A.    Since Operator services are tariffed separately from local service, GTE will make  
14          them available for resale. However, GTE proposes to offer tariffed Operator  
15          services for resale on the same terms and at the same rates as the  
16          corresponding retail offerings. There are no avoided costs associated with the  
17          wholesale provision of operator services or directory assistance; the services  
18          are offered and provided in the same manner and require the same activities,  
19          whether on a wholesale or retail basis. The offerings are provisioned, recorded  
20          and billed in the same way.

21          **G. Directories**

22          **Q.    IS DIRECTORIES EXPENSE ASSOCIATED WITH SECONDARY**  
23          **DISTRIBUTION COSTS CONSIDERED AVOIDED IN GTE'S AVOIDED COST**  
24          **STUDY?**

1 A. Yes, the workcenter associated with Secondary Distribution Costs is considered  
2 avoided in GTE's study. This decision was based on the premise that the  
3 reseller will be charged on a per directory basis for secondary distribution of  
4 directories. Actually, the costs are not avoided and will still be incurred by the  
5 Company. However, the reseller is directly compensating GTE for the cost and  
6 to avoid the CLEC paying twice for the service the workcenter is treated as  
7 avoided.

8 **Q. IF THE RESELLER IS NOT CHARGED DIRECTLY FOR SECONDARY**  
9 **DIRECTORIES, WOULD GTE'S AVOIDED COST DISCOUNT REMAIN THE**  
10 **SAME?**

11 A. No, the avoided cost discount for this state would have to be recalculated with  
12 the Secondary Directory Costs workcenter treated as 0% avoided.

13 **H. Service Ordering**

14 **Q. ARE SERVICE ORDERING COSTS AVOIDED WHEN SERVICES ARE**  
15 **OFFERED FOR RESALE AT WHOLESALE RATES?**

16 A. Service ordering costs recorded in account 6623 are not avoided costs, because  
17 ordering activities will still be required to provide retail services to CLECs for  
18 resale. Services will be ordered by CLECs with worktime and process  
19 requirements which will be more extensive for resale due to the requirement to  
20 establish a CLEC end-user account, a CLEC summary account and the GTE  
21 account. There will be few, if any, efficiencies attributable to the wholesale  
22 nature of the ordering process, and these will be offset, at least in part, by the  
additional ordering activities required as part of the wholesale ordering process.

Further, because the final Operations Support Systems (OSS) solution is not complete, a full accounting of OSS costs, as well as costs associated with interim OSS solutions, are not incorporated into the study. GTE asks the Commission for permission to revise its avoided cost study for this limited purpose once the costs associated with the final OSS solution are known.

**I. Billing & Collection**

**Q. ARE BILLING & COLLECTION EXPENSES AVOIDED WHEN SERVICES ARE OFFERED FOR RESALE AT WHOLESALE RATES?**

A. Certainly billing and collection as a type of cost will not be avoided by GTE; it will have to bill and collect from the companies to which it provides services for resale. GTE's study approaches this issue by treating retail billing and collection costs as "avoided" but then adding back in the wholesale billing and collection costs. So, in this context, Billing & Collection expenses recorded in account 6623 are not avoided in their entirety when services are offered for resale at wholesale rates. Those costs associated with the retail billing functions such as End-User Bill Distribution, Centralized Mail Remittance, Payment Agents are treated as avoided. An analysis of specific work functions is necessary to identify the costs that will be avoided.

**J. Carrier Access**

**Q. ARE CARRIER EXPENSES AVOIDED WHEN SERVICES ARE OFFERED FOR RESALE AT WHOLESALE RATES?**

A. Carrier Access expenses recorded in account 6623 are not avoided costs for the purpose of calculating a discount to the retail rates of services provided for

resale, and the associated expenses are not included in the retail rates for services that are offered for resale.

**K. Public Telecommunications**

**Q. ARE PUBLIC TELEPHONE EXPENSES AVOIDED WHEN SERVICES ARE OFFERED FOR RESALE AT WHOLESALE RATES?**

A. Public Telephone expenses recorded in account 6623 are not avoided costs inasmuch as they are similar in nature to expenses in Account 6351 discussed in Paragraph 927 of the Order, wherein the FCC stated that these expenses are not avoided because "they are unrelated to the retail services being discounted". The FCC further explained that it "would not expect these expenses to be included in retail service rates for resold services; but if these expenses were included in retail rates, they would not be avoided when the services are purchased by resellers."

Moreover, the costs of payphone services are not covered by the rate of any retail service subject to resale, so they cannot be treated as "avoided" for the purpose of calculating a discount to be applied to those resold services.

**L. Other Expenses**

**Q. SOME HAVE ADVOCATED THAT NETWORK TESTING EXPENSES SHOULD BE TREATED AS AVOIDED COSTS. IS THIS APPROPRIATE?**

A. No. GTE will be required to maintain the same service standards for its resold services as it does for its retail services. In order to ensure these quality standards, the same network testing and plant administration expenses will be incurred in a resale environment. Any testing that a reseller will do will not



alleviate the testing done by GTE, and while end-users may contact the reseller  
2 if trouble exists on their line it will be GTE's responsibility to clear the line as it is  
3 still GTE's equipment and network being utilized.

4 **Q. ARE THERE ANY OTHER EXPENSES THAT SHOULD BE INCLUDED?**

5 A. No, other than the avoided portion of indirect expenses, there are no costs that  
6 will be avoided in a wholesale environment.

7 **M. Calculation of Indirect Expense Factor**

8 **Q. SHOULD INDIRECT EXPENSES BE TREATED AS AVOIDED?**

9 A. As previously noted, an avoided cost study should include indirect, or shared,  
10 costs as well as direct costs, based on the rationale that "indirect or shared  
11 costs, such as general overheads, *support all of the LEC's functions.*" Order at ¶  
12 912 (emphasis added). Indirect expenses generally include support and  
13 overhead expenses, which the FCC found to be presumptively avoidable in the  
14 same proportion as direct expenses to total expenses. This assumes that a  
15 linear relationship exists between direct and indirect expenses.

16 **Q. HOW SHOULD THE AVOIDED PORTION OF INDIRECT EXPENSES  
17 DETERMINED?**

18 A. A linear relationship simply does not exist between direct and indirect expenses,  
19 and that the presumption of such a linear relationship has the effect of  
20 overstating the estimate of avoided indirect costs. Nonetheless, if such a  
21 relationship is to be presumed in order to determine the avoided portion of  
22 indirect costs, the formula used by the FCC in its Order is the only reasonable  
3 approach.

**Q. HOW SHOULD THE INDIRECT EXPENSE FACTOR BE CALCULATED?**

A. In its own analysis, the FCC corrected MCI's model to calculate avoided indirect expenses by applying "to each indirect expense category the ratio of avoided direct expense to total expenses." Order at ¶ 929. Use of this formula also recognizes the fact that the expenses included in the indirect expense accounts do not solely support the direct expense functions, but support the entire operations of the company.

**N. Uncollectibles**

**Q. SHOULD AN AVOIDED COST STUDY INCLUDE A PORTION OF UNCOLLECTIBLES AS AN AVOIDED COST?**

A. Yes, retail uncollectibles will be avoided in resale environment.

**Q. ARE UNCOLLECTIBLES PROPERLY TREATED AS "DIRECT" OR "INDIRECT" EXPENSES IN AN AVOIDED COST STUDY?**

A. Uncollectibles are neither direct nor indirect costs.

**Q. HOW SHOULD THE AVOIDED PORTION OF UNCOLLECTIBLES BE DETERMINED?**

A. An analysis of uncollectibles is required to determine the appropriate avoided uncollectible expense. The analysis consists of identifying the uncollectibles associated with GTE's current wholesale line of business—carrier access. These wholesale uncollectibles are then removed from the retail uncollectibles to ensure that only retail uncollectibles are considered avoided.

**Q. SOME CARRIERS CLAIM THAT THEY WILL PRESENT NO UNCOLLECTIBLE RISK SO THAT UNCOLLECTIBLES SHOULD BE DEEMED ONE HUNDRED**

**PERCENT AVOIDABLE. IS THIS A PROPER APPROACH UNDER THE ACT?**

2 A. No. The fact is that GTE experiences uncollectible rates providing access  
3 service to the carriers making that claim, and there is no reason to believe that  
4 the situation would be different with regard to resold retail services.

5 **O. Calculation of Avoided Cost Discount Rate**

6 **Q. HOW SHOULD THE AVOIDED COST DISCOUNT RATE BE CALCULATED?**

7 A. The avoided cost discount rate should be calculated as total avoided costs  
8 divided by total revenues for all services offered for resale at wholesale rates.

9 **Q. WHAT REVENUES ARE PROPERLY INCLUDED IN THE DENOMINATOR**  
10 **FOR THIS CALCULATION?**

11 A. Revenues should be included for all retail telecommunications services that  
must be offered for resale at wholesale rates.

13 Said another way, revenues should be excluded from the denominator for  
14 1) any telecommunications services which the Commission determines are not  
15 subject to resale at wholesale rates, and 2) any services that are not  
16 telecommunications services.

17 **Q. CAN YOU GIVE AN EXAMPLE OF "TELECOMMUNICATIONS SERVICES**  
18 **THAT SHOULD NOT BE SUBJECT TO RESALE AT WHOLESALE RATES"?**

19 A. Yes. Access services are not considered by the FCC to be services that the  
20 ILECs must offer for resale at wholesale rates to requesting carriers. Order at  
21 ¶¶873-874, and §51.607(b); also, any services for which the FCC or state  
22 commission grants a resale restriction. The revenues for all such services  
23 should be excluded when calculating the avoided cost discount factor.

1 Q. CAN YOU GIVE AN EXAMPLE OF "SERVICES THAT ARE NOT  
2 TELECOMMUNICATIONS SERVICES"?

3 A. Yes. "Miscellaneous services" are not telecommunications services. Also,  
4 unregulated services such as Inside Wire and Voice Messaging are not  
5 telecommunications services. The revenues for these services should be  
6 excluded when calculating the avoided cost discount factor.

7 Q. SOME HAVE ADVOCATED THAT THE DISCOUNT RATE SHOULD BE  
8 CALCULATED INSTEAD AS THE RELATIONSHIP BETWEEN AVOIDED  
9 COSTS AND TOTAL COSTS. IS THIS APPROPRIATE?

10 A. No, this approach is in direct conflict with the Act. Section 252(d)(3) of the Act  
11 states that wholesale rates shall be determined on "the basis of retail rates  
12 charged to subscribers", and thus the avoided cost discount rate should be  
13 calculated based on the relationship between avoided costs and revenues.

### 14 III. GTE's Avoided Cost Study

15 Q. WHAT DATA WERE USED TO CONDUCT THE AVOIDED COST STUDY?

16 A. The study we are presently submitting to illustrate the Company's methodology  
17 is based on 1995 ARMIS data as filed with the FCC, for all study areas within the  
18 state combined. Both direct and indirect expenses are included in the study, as  
19 well as uncollectibles. The model simply applies avoided cost factors to ARMIS  
20 data as filed the FCC.

21 The factors applied to marketing and services direct expense accounts  
22 are developed in a detailed analysis of GTE workcenter activities. The source  
23 for these factors, as well as certain factors calculated internal to the model, is

fully documented within the avoided cost study.

2 **Q. PLEASE DESCRIBE THE DETAILED ANALYSIS USED BY GTE TO DEVELOP**  
3 **THE DIRECT EXPENSE ALLOCATORS USED IN THE MODEL.**

4 A. This analysis was designed to determine the appropriate avoided cost factors to  
5 apply to marketing and services expense accounts; the FCC's First Report and  
6 Order had established presumptive factors to be used temporarily for this  
7 purpose.

8 The analysis is conducted on an incurred cost basis using actual  
9 workcenter costs for all workcenters in GTE's total telephone operations. The  
10 workcenters are organized in logical groups based on the primary work functions  
11 performed, to facilitate the necessary judgments about specific activities that will  
be avoided when GTE offers services for resale at wholesale rates.

13 In this analysis, a determination is made for each workcenter as to  
14 whether the activities and associated expenses will be avoided when services  
15 are offered for resale; such a determination can reliably be made only by  
16 examination of sufficiently detailed financial information. Generally, costs for  
17 each workcenter were classified as either "all avoided" or "none avoided";  
18 however, for the "sales" workcenters, a percent avoided was calculated using  
19 the relationship between actual GTE retail and wholesale (*i.e.*, carrier access)  
20 sales expenses in comparison to the corresponding revenues. Attachment 2B of  
21 the Avoided Cost Study details this calculation.

22 In general, avoided workcenter costs for each direct expense account are  
calculated by applying the percent avoided for the workcenter to total costs for

1 the workcenter by account. For customer service expenses, account 6623,  
2 workcenter costs were first adjusted to recognize that GTE will not avoid carrier  
3 access (IXC), public telephone (PubCom) and service ordering (S.O.) expenses  
4 when services are offered for resale; the remaining workcenter costs recorded to  
5 this account were then treated as described above to determine avoided  
6 workcenter costs.

7 Attachment 2A, page 1 of 5, summarizes the results of these calculations,  
8 and the avoided cost factor applicable to the marketing and services expense  
9 accounts is calculated by account as the avoided expenses for all workcenters  
10 divided by the total expenses for all workcenters, excluding G&A and support  
11 workcenters; the latter step has the effect of identifying as avoided a pro rata  
12 share of expenses recorded to these workcenters. The resulting avoided cost  
13 factors for the six ARMIS accounts are then used in the state-specific avoided  
14 cost analysis documented in Attachment 1A.

15 **Q. WOULD YOU PLEASE DEFINE THE TERM "WORKCENTER?"**

16 **A.** A workcenter is defined as a collection of activities that exhibit: (1) common  
17 functions; (2) a common unit measure of demand; (3) a common unit measure of  
18 resource consumption; (4) a common geographic uniqueness; and/or (5) a  
19 common management structure. Most of the workcenters are defined based on  
20 common functions or work activities.

21 **Q. WHY WERE RESULTS FOR GTE'S TOTAL DOMESTIC OPERATIONS USED**  
22 **IN THIS PART OF THE ANALYSIS, RATHER THAN RESULTS SPECIFIC TO**  
**THIS STATE?**

1 A. The necessary data are not incurred on a state specific basis, so data specific to  
2 operations in this state are not available from GTE's records. This is because  
3 the vast majority of the affected activities are performed on a centralized basis  
4 from regional and national service centers located throughout the country. Each  
5 of these centers handles one or more specific retailing functions for a number of  
6 different states. For example, the National Customer Contact Support Center  
7 located in Tampa, Florida provides nationwide support for the customer contact  
8 centers by clearing order entry exceptions and processing customer  
9 correspondence. A complete listing and description of these centralized  
10 functions is provided as Attachment 2C (Workcenter Glossary) of GTE's Avoided  
11 Cost Study.

12 Because the functions are organized and managed in this way, the  
13 associated costs for all affected activities taken together are not meaningful at  
14 other than a total GTE Telephone Operations level.

#### 15 IV. Summary

16 **Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?**

17 A. Yes. The avoided cost study methodology proposed by GTE correctly applies  
18 the provisions of the Act and accurately quantifies the costs GTE will avoid when  
19 providing retail telecommunications services for resale. The Commission should  
20 approve use of GTE's methodology in Phase 2 of this matter.