BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

UT-960307

In the Matter of the Petition of AT&T	)
Communications of the Pacific Northwest, Inc.	)
For Arbitration of Interconnection Rates,	)
Terms and Conditions with GTE Northwest	)
Incorporated, Pursuant to 47 U.S.C. Sec.	)
252(B) of the Telecommunications Act of	)
1996.	)

BRIEF OF

GTE NORTHWEST INCORPORATED

November 15, 1996

TABLE OF CONTENTS

Page

INTRODUCTION 1

I. The Arbitrator Should Ignore the Stayed Pricing Provisions of the first Report and Order.5
- A. Background Leading to the Stay 6
  - 1. The Telecommunications Act of 1996................................6
  - 2. The FCC's First Report and Order 7
- B. The Decision of the Eighth Circuit 9
  - 1. Likelihood That GTE Will Succeed on the Merits 10
  - 2. Irreparable Harm to GTE 11
  - 3. The Arbitrator Should Not Rely on the Stayed Rules 12

II. The Arbitrator Should Adopt GTE's Pricing Proposals For Unbundled Network Elements And Interconnection 14
- A. Overview...14
- B. The GTE Proposed TELRICs Are The Appropriate Starting Point For Pricing of Interconnection and Unbundled Elements...18
  - 1. GTE's Cost Studies Are Sound 18
  - 2. The Hatfield Model Cannot Be Used 21
  - 3. The FCC Proxy Rates Cannot Be Used To Set Prices..............................28
- C. GTE's Pricing Proposals Should Be Adopted...29
  - 1. GTE's Common Costs Are Substantial..29
  - 2. Prices Must Reflect The Fact That GTE's Common Costs Are Substantial...32
  - 3. M-ECPR Pricing Is The Appropriate Method For Promoting Competition And Recovering Common Costs 34
  - 4. AT&T's Criticisms of M-ECPR Pricing Are Without Merit 38

III. The Arbitrator Should Adopt GTE's Proposed Avoided Cost Discount For Resale. 39
- A. Overview...39
- B. GTE's Avoided Cost Studies...41
  - 1. GTE's Original Avoided Cost Study..41
  - 2. GTE's Modified Avoided Cost Study 42
- C. AT&T's Avoided Cost Study 45

D. GTE's Proposed Avoided Cost Discount Must Be Chosen Over AT&T's Proposal 46

IV. The Act and the Eighth Circuit Order Make Clear The Requirement that the Arbitrator Apply GTE's Economic and Cost Evidence, and the Act Provides Ample Time for Such Consideration 49
A. Sequence and Timing 49
B. The Arbitrator Should Adopt GTE's Rates On An Interim Basis 55

V. MATRIX ISSUES 57
Resale/Avoided Cost Issues 57
Issue #1 57
Issue #10 65
Issue #11 65
Issue #13 66
Issue #14 67
Issue #15 67
Issue #16 68
Unbundling/Interconnection 68
Issue #3 68
Issue #4 68
Issue #17 69
Issue #18 70
Issue #19 73
Issue #20 75
Issue #21 75
Issue #30 76
Issue #31 78
Issue #32 79
Issue #33 80
Issue #34 81
Issue #39 83
Issue #40 84
Issue #41 85
Issue #42 85
Issue #43 87
Default Proxies 87
Issue #2 87
Parity/Quality 88
Issue #26 88
Issue #27 88
Issue #28 90
Number Portability Issues 91
Issue #6 91

Issue #48 93
Poles, Conduits, Ducts, and Rights-of-Way Issues 95
Issue #8 95
Issue #55 96
Issue #56 98
Issue #57 99
Issue #58 101
Operational Support Services (OSS) 101
Issue #23 101
Issue #24 102
Issue #25 105
Issue #44 105
Issue #45 107
Issue #46 108
Issue #47 108
Issue #67 108
Issue #68 109
SS7/AIN Issues 110
Issue #35 110
Issue #36 111
Issue #37 112
Issue #38 113
Issue #69 114
Issue #7 115
Issue #49 115
Issue #50 118
Issue #51 121
Issue #52 123
Issue #53 123
Issue #54 125
Ancillary Services 126
Issue #22 126
Issue #29 126
Issue #5 128
Issue #12 130
Issue #59 132
Issue #60 134
Issue #61 135
Issue #62 136
Issue #63 138
Issue #64 138
Issue #65 141
Issue #66 141

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of AT&T Communications of the Pacific Northwest, Inc. For Arbitration of Interconnection Rates, Terms and Conditions with GTE Northwest Incorporated, Pursuant to 47 U.S.C. Sec. 252(B) of the Telecommunications Act of 1996	)))))))	UT-960307

BRIEF OF
GTE NORTHWEST INCORPORATED

INTRODUCTION

This proceeding calls on the arbitrator to do two main things: (1) set prices for unbundled network elements, interconnection, and resale that will encourage efficient entry into local exchange markets and (2) accomplish this without taking GTE Northwest Incorporated's ("GTE") property. The first of these objectives flows from the Telecommunications Act of 1996. The second flows from the Fifth Amendment to the United States Constitution.

GTE's pricing proposals will enable the arbitrator to achieve both of these objectives. By setting prices for unbundled elements and interconnection based on a market determined price -- and permitting that price to fall based on market forces -- GTE's proposal encourages efficient entry in the same way markets do. By proposing a resale rate based on a proper analysis of the retailing costs GTE will avoid, taking into account the wholesaling costs it will incur, GTE's proposal

similarly will encourage resale by potential entrants who are equally efficient or more efficient than GTE at retailing.

GTE's pricing proposals will also minimize any taking because the proposals enhance GTE's opportunity to recover its forward looking common costs. To the extent that GTE has stranded costs that cannot be recovered through its pricing proposals, a competitively neutral end-user charge will be required in order to avoid a taking.

The proposal of AT&T Communications of the Pacific Northwest, Inc. ("AT&T), on the other hand, accomplishes neither of the arbitrator's objectives. It sets prices for unbundled network elements well below even GTE's incremental costs, and sets prices for resale at levels far below the retail price less the costs GTE will avoid by not retailing. It derives these absurdly low prices through a studied unwillingness to analyze GTE's actual costs. The bargain basement prices for unbundled elements are the product of the Hatfield Model. This is a black box methodology under which AT&T has created an imaginary network from scratch, based on flawed assumptions and incorrect inputs, and then decreed that the costs of this hypothetical network that will never be built constitute GTE's forward looking costs. Similarly, the prices for resale are the product of a blanket refusal to analyze the costs GTE will incur as a wholesaler. Again, AT&T resorts to proxies which have no real world connection to GTE.

Implementation of AT&T's proposed prices would encourage entry by inefficient firms seeking to take advantage of subsidies. Even AT&T concedes that this is not the purpose of the Telecommunications Act. (Mayo Tr. 414)

Indeed, it would undercut a primary purpose of the Act -- encouragement of facilities based competition. Entrants who receive GTE's services and inputs at subsidy prices clearly will have no incentive to build facilities of their own. (Doane Tr. 387; Mayo, Doane 513-14) Moreover, efficient entrants may well be crowded out by inefficient entrants who are drawn into the market by subsidies.

Implementation of AT&T's pricing proposals would also guarantee an unconstitutional taking. A regulated entity such as GTE may not be forced to provide services below cost without just compensation. See Brooks-Scanlon Co. v. Railway Comm'n of Louisiana, 251 U.S. 396, 399 (1920). This rule applies even if the regulated entity is forced to provide below cost services only temporarily. For, as the United States Court of Appeals for the Eighth Circuit recognized when it stayed the proxy rates established in the Federal Communications Commission's ("FCC") First Report and Order, the incumbent local exchange carriers ("ILECs") will be unable to recover the economic losses that will result from even the temporary imposition of below cost prices. Iowa Utilities Board, et al. v. FCC, et al. (Docket No. 96-3321, et al.), Order of October 15, 1996 ("Stay Order") at 18-19.

In short, if the Washington Utilities and Transportation Commission ("Commission") and the State of Washington implement AT&T's pricing proposals, the stayed FCC proxy rates, or any other regime which sets prices below GTE's costs, the State of Washington will be responsible for an unconstitutional taking. It will be no defense to argue that, if GTE had constructed and deployed the hypothetical network imagined by Hatfield and

Associates, the arbitrator's prices might have been appropriate. And it certainly will be no defense to rely on the FCC proxy rates, which have been stayed by the Eighth Circuit and, accordingly, do not exist for purposes of the arbitrator's determination. See, e.g., Cuff v. International Bus. Mach. Co., No. 92-6936, 1992 WL 12961 at *3 (E.D. Pa. 1992); Crouch v. Indiana, 638 N.E. 2d. 861, 864 (Ind. Ct. App. 1994); Katratis v. Dav-el, No. 86-2519, 1987 WL 8535, at *2, n.5 (E.D. Pa. 1987).

For all the reasons set forth more fully below, the arbitrator should reject the FCC's proxy rates as well as the proxy rates manufactured by the Hatfield Model and instead focus on the evidence of record in this proceeding that is directly pertinent to GTE's actual experience in providing service to Washington consumers. Only in this fashion can the arbitrator comply with the mandates of the Act and avoid the liability AT&T so cavalierly asks the state to assume in order to subsidize AT&T's entry into this state's local exchange market.

* * *

This brief is divided into five sections. Section I will explain that the FCC's proxy rates cannot be considered or relied upon in this proceeding because they have been stayed by the Eighth Circuit. Sections II and III will explain why GTE's proposed rates should be adopted, and will demonstrate how AT&T's proposals have absolutely no relation to the costs of GTE's network in Washington. Section IV will discuss briefly the statutory requirements regarding the timing for resolving open issues and concluding a contract. Finally, Section V will substantiate GTE's position on every issue identified in the parties' joint matrix.

I. The Arbitrator Should Ignore the Stayed Pricing Provisions of the first Report and Order.

On October 15, 1996, the United States Court of Appeals for the Eighth Circuit stayed the "operation and effect" of the FCC's pricing rules. See Order Granting Stay Pending Judicial Review, Nos. 96-3321 et al. (Oct. 15, 1996) (the "Stay Order") at 8. (A copy of the Stay Order is attached.) The Eighth Circuit concluded that a stay was required because GTE and the other petitioners made a "strong argument" that the FCC acted beyond the scope of its authority in establishing pricing rules in its regulations and that GTE and others would suffer irreparable injury in the absence of a stay. Id. at 13.

The consequences of the Court's ruling are clear. First, the arbitrator may not rely on any aspect of the FCC's pricing rules, including the FCC's default proxy rates and pricing methodologies. Second, the Stay Order makes clear that it is the arbitrator's statutory duty to hold localized, case-specific determinations, applying the Act and state law, to establish "just and reasonable" rates for interconnection with GTE's network. Finally, the Stay Order makes more compelling the case for relying on GTE's proposed rates for unbundled network elements and resale services, which are supported by extensive cost studies and economic testimony now in the record.

A. Background Leading to the Stay

1. The Telecommunications Act of 1996

Sections 251 and 252 of the Act generally provide the statutory mechanisms for implementing the goal of promoting competition in local telephone service. 47 U.S.C. §§ 251-252. The Act seeks to accomplish this objective by imposing on incumbent local exchange carriers, such as GTE, the duty to provide interconnection and access to unbundled network elements at "just and reasonable" rates to be determined by state public utility commissions. 47 U.S.C. §§ 521(c)(2)-(3). The Act provides that rates for interconnection and unbundled elements shall be "based on cost" and "may include a reasonable profit." 47 U.S.C. § 252(d)(1). In addition, the Act provides that ILECs must offer for resale at wholesale rates any retail services provided by the ILEC to customers that are not telecommunication carriers. 47 U.S.C. § 251(c)(4).

> State commissions are directed to determine wholesale rates on the basis of retail rates . . . excluding the portion thereof attributable to any marketing, billing, collection, and other costs that will be avoided by the local exchange carrier.

47 U.S.C. § 252(d)(3).

If the parties are unable to reach agreement on the terms of interconnection through negotiation, either party may petition the arbitrator to resolve any open issues through a compulsory and binding arbitration. 47 U.S.C. § 252(b). In resolving any issues by arbitration and imposing conditions on the parties pursuant to Section 252(b), the Act provides that the arbitrator <u>shall</u> ensure that the award is consistent with the requirements of Section 251, including the FCC's lawful regulations pursuant to Section 251, and establish rates for interconnection and unbundled elements according to Section 252(d).

47 U.S.C. § 252(c). Any arbitration award must then be approved by the Commission. 47 U.S.C. § 252(e)(1). The Commission must also review the award to ensure compliance with Section 251 and the pricing methodologies of Section 252(d). The decision of the Commission, in turn, is reviewable in federal district court, which must "determine whether the agreement . . . meets the requirements of Section 251 [and Section 252]." 47 U.S.C. § 252(e)(6).

2. The FCC's First Report and Order

On August 8, 1996, in flagrant disregard of the congressional mandate that state commissions alone make the pricing determinations required by the Act, the FCC released its First Report and Order, a 700-page bureaucratic re-write of the Act. See In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, FCC 96-325 (Aug. 8, 1996) ("First Report and Order"). In the First Report and Order, the FCC improperly attempted to regulate intrastate, local telephone service by unilaterally imposing pricing methodologies and default proxy rates for determining rates for interconnection, unbundled elements, and resold services. See generally First Report and Order, ¶¶ 767-836.

The First Report and Order "strongly encourage[s] state commissions, as a general rule, to set arbitrated rates for interconnection and access to unbundled network elements pursuant to the forward-looking, economic cost pricing methodology we adopt in this Order." Id. at ¶ 767. The FCC further provided, however, that state commissions may conduct cost studies in a separate rulemaking rather than in an arbitration because "in some cases, it may

not be possible for carriers to prepare or the state commission to review, economic cost studies within the statutory time frame for arbitration. . . ." Id. In such cases, the FCC purports to direct state commissions to adopt certain default proxy rates for interconnection and unbundled elements until such time as the arbitrator adopts forward-looking costs using the pricing methodology imposed by the FCC's Total Element Long-Run Incremental Cost ("TELRIC"). Id.

The FCC also attempted to establish a methodology for calculation of avoided costs, for purposes of determining resale rates, and announced a default range of discount rates from 17 to 25 percent below retail rates as a proxy for the ILECs' avoided costs. Id. at ¶ 932. The FCC directed state commissions to apply discounts within that range until the arbitrators can review and approve an avoided cost study that complies with the FCC's prescribed methodology. Id. at ¶ 910.

B. The Decision of the Eighth Circuit

In response to the FCC's attempted usurpation of authority that for over 60 years has been vested exclusively with the state commissions, a number of state commissions and ILECS, including GTE, filed motions in the Eighth Circuit to stay the FCC's regulations pending resolution of the merits of their petitions for review of the First Report and Order.[1/] The central contentions of the stay

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[1]Motions for stay were filed on behalf of several states and their public utility commissions, including Iowa Utilities Board, the Louisiana Public Service Commission, the Florida Public Service Commission, and the South Dakota Public Utilities Commission. ILECs also filed stay motions, including GTE, the Southern New England Telephone Company, U S WEST, Inc., and Cincinnati Bell Telephone Company.

motions were that the FCC had no authority whatsoever to impose pricing methodologies and default proxy rates for intrastate telephone service; and that the FCC's methodologies and proxy rates, in any case, were arbitrary and capricious and effected an unconstitutional taking without just compensation in violation of the Fifth Amendment.

On October 15, 1996, the Eighth Circuit "stay[ed] the operation and effect" of the "pricing provisions" and the "pick and choose" rule contained in the First Report and Order. Stay Order at 8. The Court's stay extended to every portion of the FCC's pricing rules, and was founded on the Court's conclusion that GTE was likely to prevail on the merits because the FCC had no intra-state pricing authority, and GTE and others would suffer irreparable injury without a stay.[1/]

In deciding whether to grant the stay requested by GTE, the Eighth Circuit was required to decide whether (1) GTE was likely to succeed on the merits; (2) GTE was likely to suffer irreparable harm if the FCC's rules remained in effect pending the final decision; (3) AT&T and others would be harmed if the stay was granted; and (4) the public interest would be served in granting the stay. The court found that all of these factors weighed in favor of GTE.

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[2]The Eighth Circuit's Stay extended to the pricing rules of the FCC's First Report and Order: Subpart F ("Pricing Of Elements", 47 C.F.R. §§ 51.501 - 51.515); Subpart G ("Resale," 47 C.F.R. §§ 51.601 - 51.611); Subpart H ("Reciprocal Compensation for Transport and Termination of Local Telecommunications Traffic," 47 C.F.R. §§ 51.701 - 51.717); Subpart I ("Procedures for Implementation of Section 252 of the Act, 47 C.F.R. §§ 51.809); and the proxy range for line ports used in the delivery of basic residential and business exchange services established in the FCC's Order on Reconsideration, dated Sept. 27, 1996. See Order at 9 n.3, 21.

1. Likelihood That GTE Will Succeed on the Merits

The Court concluded that a stay was necessary because petitioners had demonstrated that they "will likely succeed on the merits of their appeals based on their argument that, under the Act, the FCC is without jurisdiction to establish pricing regulations regarding intrastate telephone service." Stay Order at 16 (emphasis added). The Court supported this conclusion by finding that "nowhere in section 251 is the FCC specifically authorized to issue rules on pricing" and that

> Congress intended to grant the state commissions the authority over pricing of local telephone service, either by approving or disapproving the agreements negotiated by the parties, or, when the parties cannot agree, through compulsory arbitration, thereby preserving what historically has been the States' role.

Id. at 14 (emphasis added).

Furthermore, the Court expressed its "serious doubts" that the FCC's interpretation of the Act constituted the "straightforward or unambiguous" grant of authority necessary to qualify as an exception to Section 2(b) of the Communications Act of 1934, which restricts the FCC's authority to inter-State matters, not intra-State. The Court further concluded that the FCC's "roundabout construction of the statute" conflicts with "what, at first blush, appears to be a rather clear and direct indication . . . that the state commissions should establish prices." Id. at 15 (emphasis added).

2. Irreparable Harm to GTE

Specifically, the Court ruled that GTE would be irreparably harmed if the

pricing methodology mandated by the FCC were forced on GTE. The Court accepted GTE's argument that the FCC pricing methodology would force GTE to offer its services to carriers like AT&T at prices that are below actual costs, causing GTE to incur irreparable losses in customers, goodwill and revenue. Stay Order at 18. The Court found, in effect, that imposition of the proxy rates would penalize GTE in the transition to an environment market in which carriers are free to compete for the local market:

> As we explained above, we are persuaded that, absent a stay, the proxy rates would frequently be imposed by the state commissions and would result in many incumbent LECs suffering economic losses beyond those inherent in the transition from a monopolistic market to a competitive one.

Stay Order at 18.

The Court was similarly concerned that the FCC's "pick and choose" rule would cause irreparable injury. The FCC's "pick and choose" rule would allow a competitive local exchange carrier to "cherry pick" favorable provisions from a variety of different agreements, without regard to the arbitration or negotiation of the agreement. As such, the FCC's "pick and choose" rule went well beyond the provision of the Act that requires ILECs to make available interconnection, services or network elements on the same terms and conditions as those provided under other agreements approved under the Act. See 47 U.S.C. § 252(I). Accordingly, the Court held that the FCC's "pick and choose" rule would cause irreparable injury by "further undercut[ting] any agreements that are actually negotiated or arbitrated." Stay Order at 17.

By its Stay Order, the Eighth Circuit has effectively rejected the pricing

mechanisms of the FCC that have been adopted by AT&T in this proceeding. Now that the "handcuffs" of the FCC pricing rules have been removed, the arbitrator is free to fulfill his congressionally-delegated duty to determine rates for GTE's services that are "just and reasonable." Section 252(d) of the Act; Stay Order at 13, 20.

3. The Arbitrator Should Not Rely on the Stayed Rules.

The FCC's pricing provisions may not be enforced or relied upon by anyone—including the FCC, this arbitrator, or any party to this arbitration. Until further Order of the Court, the FCC's pricing rules should be treated as if they never existed.[1/] Indeed, to treat the FCC's pricing rules in any other manner would run directly contrary to the principles underlying stays of administrative actions, as expressed over fifty years ago in Scripps-Howard Radio, Inc. v. FCC, 316 U.S. 4, 9, 62 S. Ct. 875, 86 L. Ed. 1229 (1942) (Frankfurter, J).: "an appellate court should be able to prevent irreparable injury to the parties or to the public resulting from the premature enforcement of a determination which may later be found to have been wrong."[1/]

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[3]The Eighth Circuit's decision staying the First Report and Order is binding nationwide. The Eighth Circuit was selected pursuant to the "lottery statute," 28 U.S.C. § 2112(a), as the only Court of Appeals to hear the multiple petitions for review that were filed after the publication of the First Report and Order. Under the "lottery statute," the Eighth Circuit was chosen at random to hear all petitions for review and related matters, including the stay requests. Pursuant to the "lottery statute," no other Court will be authorized to consider a review of the First Report and Order. That means that the Court's Order is binding on this and every Commission and state.

[4]Scripps-Howard continues, stating that a stayed order cannot be applied because "[i]f the administrative agency has committed errors of law for the correction of which the legislature has provided appropriate resort to the courts,

such judicial review would be an idle ceremony if the situation were irreparably changed before the correction could be made." 316 U.S. at 10.

AT&T may argue that the Eight Circuit's decision was "merely jurisdictional," and that the arbitrator could therefore look to the stayed provisions for guidance or advice. This interpretation of the Stay Order would render it meaningless. In particular, it ignores the Court's unambiguous decision that adoption of the FCC's interim proxy rates and wholesale discount would cause irreparable harm to GTE.

Since the pricing provisions of the First Report and Order are not effective, they do not exist for purposes of the arbitrator's determination. Accordingly, the arbitrator cannot impose the same pricing provisions nullified by the Eighth Circuit in the guise of using the "methodology" of the FCC First Report and Order. See, e.g., Cuff v. International Bus. Mach. Co., No. 92-0936, 1992 WL 129610, at *3 (E.D.Pa. 1992); Crouch v. Indiana, 638 N.E.2d 861, 864 (Ind.Ct.App. 1994); Katradis v. Dav-el, No. 86-2519, 1987 WL 8535, at *2 n.5 (E.D.Pa. 1987).

The Eighth Circuit's well-reasoned, thorough opinion leaves no doubt that the FCC's pricing rules cut squarely against the regime envisioned by Congress for conducting arbitrations. The Court concluded that the FCC's pricing provision prevents "free negotiations" between parties, artificially fixes the results at unjustifiably low prices, and obstructs the very case-specific, individualized decision-making required under the Act.

In light of the Stay Order, there can be no justification for any future—or continued—use of the FCC's default proxy rates. There is no support in the record of this arbitration that could otherwise justify the default proxy rates.

II. The Arbitrator Should Adopt GTE's Pricing Proposals For Unbundled Network Elements And Interconnection

A. Overview

The Telecommunications Act establishes a clear pricing standard for unbundled network elements and interconnection. The arbitrator "shall" determine "just and reasonable" rates and such rates "shall" be based on cost and may include a reasonable profit. Section 252(c), (d)(1). The arbitrator's determination of "just and reasonable" rates must be based on competent, reliable, and relevant evidence. Nothing in the Act suggests that the incumbent LECs shall have the burden of proof as to what rates are just and reasonable.

Against this statutory backdrop, two issues underlie the parties' dispute in this proceeding over pricing of unbundled elements and interconnection: (1) what are the TELRICs for these items and (2) what should be added to the TELRICs in setting prices. Both parties agree that TELRICs constitute the starting point for pricing purposes and that something must be added to the TELRICs to reflect, at a minimum, GTE's common costs.[1/]

GTE submits that the most accurate estimates of its TELRICs are to be found in its state and company specific cost studies. AT&T, on the other hand, insists that the TELRICs should be determined by the flawed and purely

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[5/] The terms "common costs," "joint and common costs," and "shared costs" encompass all costs that are <u>not</u> included in GTE's TELRICs.

hypothetical Hatfield Model.

AT&T's position is without merit. As discussed in detail below, the Hatfield Model is unproven and untested. The Model is based on a hypothetical network that will never be built. Thus, it has nothing to do with GTE's costs of providing facilities and services in Washington. Moreover, it contains unfounded assumptions and inputs that are biased in favor of depressing prices. In fact, the Model produces prices so low that AT&T could purchase unbundled elements, rebundle them to replicate GTE's basic service, and sell that service at a discount of more than 70 percent below GTE's retail price. (Tr. 719) This is more than twice the wholesale discount that even AT&T advocates. Thus, the Hatfield Model fails the most basic of reality checks.

GTE's cost studies, by contrast, are firmly and reliably rooted in the realities of GTE's Washington operations on a forward looking basis. As such, they provide the TELRICs that should be adopted as the starting point for setting prices.

As to the second issue -- what should be added to the TELRIC -- both parties agree that, at a minimum, something should be added to reflect GTE's common costs. AT&T contends that the price should arbitrarily be increased to just 10 percent above TELRIC for each element. GTE has established, however, that its common costs are such that AT&T's proposed ten percent increase is woefully insufficient to recover them. As discussed in detail below, GTE has presented two methods of analyzing its common costs, both of which show that common costs exceed one- third of total costs. Thus, if common costs were to

be recovered through a simple fixed allocation across the board, the increase to TELRICs would have to exceed 50 percent.[1/]

However, GTE's pricing proposals reject this simplistic fixed allocator approach. Instead, pursuant to the M-ECPR methodology discussed below in detail, GTE proposes to set prices at market determined competitive price levels. Prices are capped for each unbundled element at the price of its market alterative. For example, the proposed price for a loop -- $30 -- is based on the market price for a two-wire special access line, the market alternative to a loop. The fixed allocator is used, not as the method for setting prices, but as a benchmark to test the extent to which, on the whole, GTE's proposed prices recover forward looking common costs. Indeed, as a practical matter, the fixed allocator cannot be used to set prices. For if the allocator drives prices above the market alternative -- $30 in the case of the loop -- GTE will be unable to sell its input at that price.

GTE's pricing proposals satisfy the requirements of the Act and the Constitution. The market based prices will encourage efficient entry and allow prices to drop as changing market conditions dictate. These prices will also allow GTE to recover its forward looking common costs to a far greater degree than will

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[6/] To illustrate how this fixed allocator would work, consider a situation in which a firm's common costs were $33,000 and its TELRICs totaled $67,000. In this situation, in which common costs represent about one-third of total costs, the fixed allocator would be approximately 50 percent, i.e. the percentage needed to raise $67,000 to $100,000.

AT&T's meager and arbitrary 10 percent fixed allocator.

B. The GTE Proposed TELRICs Are The Appropriate Starting Point For Pricing of Interconnection and Unbundled Elements

1. GTE's Cost Studies Are Sound

GTE is the only party in this arbitration that has presented cost studies based on the forward looking costs GTE will incur in providing local telephone service to Washington in the future. Its cost studies reject both the "embedded" approach -- in which even obsolete technologies are assumed to be used on a forward looking basis -- and the hypothetical approach -- in which assumptions are divorced from the concrete circumstances GTE faces on a going forward basis. (Omoto Tr. 630) Instead, the cost studies analyze GTE, but without regard to those past practices that lack relevance to the future. (Id.) In doing so, they rely on Washington specific data, including Washington customer specific loop sample information, labor rates, and cost factors. (Omoto Tr. 631)

In addition, GTE's cost studies possess all of the key attributes of a proper study of forward looking, long run incremental costs. First, they are incremental -- they study the costs of offering the service or element versus the costs of not offering it. (Omoto Tr. 630) Second, the cost studies follow principles of cost causation. The company's cost studies include both the volume-sensitive and the volume-insensitive costs attributable to the precise element in question, and exclude the common or shared costs that are necessary to the operation of the company as a whole. (Omoto Tr. 629-30)

Third, the cost studies are forward looking. They are based on forward-

looking technology and forward-looking fill factors. For example, with respect to technology, the cost models assume digital switches and fiber technology for interoffice transport. (Omoto Tr. 631) Although the company presently continues to use analog switches and transmission facilities, GTE recognizes that this technology is outdated, and therefore excludes it from the study. No obsolete technology is used. (Omoto Tr. 636) GTE relies instead on the current network design standards that are presently utilized by GTE in provisioning loops, switching, and transport facilities in Washington. (Tr. Omoto 631)

GTE's cost studies use fill factors of 55 percent. This factor represents the average forward-looking fill factor for the state. (Omoto Tr. 630) It is forward looking because there is no reasonable basis for concluding that fill factors will increase in the future. (Omoto Tr. 663) If anything, as Dr. Lawrence Cole explained, fill factors are likely to decrease due to facilities based competition. (Cole Tr. 564) Experience in the interexchange carrier business supports this prediction. (Id.)

GTE's cost studies, in fact, are conservative, not only with respect to fill factors, but also with respect to the cost of money and depreciation. (Omoto Tr. 631) As Craig Omoto testified, GTE's studies should have adjusted depreciation and cost of capital to reflect the increased risk that providers of capital face in the new, competitive environment, as well as likely innovations in technology. (Omoto Tr. 632) Had GTE made these adjustments, its TELRICs would have been higher. (Id.)

In the face of GTE's conservative company and state specific studies,

AT&T confined itself to complaining that the studies are not sufficiently open, and to identifying a few minor areas in which it disagreed with GTE's approach. As to the first criticism, much of the problem stems from AT&T's refusal to sign the confidentiality agreements required by certain vendors (*e.g.*, Bellcore) before information could be released. (Tr. 596-597) The agreement contained language insisted upon by GTE's vendors pursuant to license agreements, which GTE would have violated had GTE turned over the data without restriction. Even so, GTE presented detailed information and documentation to support its studies. The level of detail and documentation is comparable to that used to set rates by Commissions throughout the country. (Omoto Tr. 632) Similar studies have been presented to this Commission in recent tariff and contract filings. (Omoto Tr. 633)

AT&T's substantive criticisms are insufficient to warrant rejection of the studies by the arbitrator. John Klick identified a few areas of disagreement with the studies' assumptions regarding loops. Craig Omoto defended GTE's treatment of copper costs (Omoto Tr. 658), and demonstrated that Klick's criticism of the treatment of loops in excess of 24,000 feet would have a minimal effect on the result of the study. (Omoto Tr. 659) As noted, GTE's study has erred on the side of conservatism in several key respects. In so doing, GTE has left room to offset the consequences of the types of issues raised by AT&T.

Ultimately, Klick agreed that his disagreement with GTE's results boiled down essentially to fill factors. (Klick Tr. 654) As explained above, GTE's fill factors are reasonable, forward looking, and, if anything, conservative. There is

no record evidence that would support the use of the substantially higher factors Klick and AT&T advocate.

In short, GTE's studies remain the only source of useful company and state specific information about GTE's costs in Washington. They should not be rejected because they are not perfect.[1/]

2. The Hatfield Model Cannot Be Used To Define TELRICs

AT&T's beleaguered Hatfield Model cannot serve as the basis for determining GTE's real costs in Washington or anywhere else. The Hatfield Model is based on a scenario -- the construction from scratch of an entirely new network -- which is simply irrelevant to a determination of GTE's forward looking costs. Moreover, even under a more realistic scenario, the Model is simply too flawed to be of any use.

The Model's manifold shortcomings can be grouped into four general categories. First, the Model is untested and untrustworthy. Second, the Model's core assumptions are counter-factual. Third, many of the Model's other specific assumptions and inputs plainly are erroneous and are biased to produce lower costs. Fourth, as a result, the Model produces prices that are so low as to be inconsistent with even AT&T's stated position of what is reasonable.

[7/] Craig Omoto demonstrated in detail why the criticisms of GTE's California cost studies by the California Commission cannot be persuasive when applied to GTE's Washington studies. (Tr. 637-640) This testimony was not rebutted.

a. The Hatfield Model Is Untested and Untrustworthy

The Hatfield Model purports to be expert opinion evidence. As such, it must meet certain standards of scientific and technical reliability and validity before this arbitrator can rely on, or even consider, it. Indeed, the arbitrator is bound by law to rely only on evidence that is reliable and not based on speculation or supposition. See, e.g., Tamiami Trail Tours, Inc. v. Beves, 299 So. 2d 22, 24 (1974). To qualify as scientific or technical knowledge, the testimony must be grounded in the methods or procedures of the scientific or technical field. Daubert v. Merrill Dow Pharmaceutical, Inc., 113 S.Ct. 2786, 2795 (1993).

The Hatfield Model does not meet these minimum criteria. The Model has never been tested or otherwise independently verified. (Cole Tr. 545) No effort has been made to compare the results generated by the Model with the costs of real projects that recently have been completed. (Cole Tr. 559) Moreover, the Model generates much lower costs and prices than the less partisan, more objective BCM 2 model. (Cole Tr. 550-551, 583)

The Hatfield Model "has undergone a large number of revisions in a relatively short period of time." (Cole Tr. 558) This creates a strong likelihood that there still are many "bugs" in its highly complex codes and multitude of cells and equations. (Cole Tr. 558)

In fact, the Model's sponsor, Robert Mercer, admitted that Hatfield & Associates is still finding bugs, which require corrections that have not yet been made. (Mercer Tr. 609) Mercer candidly admitted that the Model is "a work in

progress." (Mercer Tr. 610) It is commendable that Hatfield & Associates is attempting to iron out the problems with its Model. However, the arbitrator should not base its decisions on the crucial cost and pricing issues in this arbitration on a "work in progress." The economic and constitutional stakes are too high.

b. The Model's Underlying Assumptions Are Incorrect

The Hatfield Model assumes that it is appropriate to estimate GTE's forward looking costs without regard to the actual circumstances that GTE (or any real-world ILEC) confronts. It assumes that GTE's costs should be estimated based on the fanciful assumption that GTE will instantaneously rebuild its entire telephone network. (Cole Tr. 545-546)

As Dr. Cole testified, no useful cost question can be answered by modeling something that is both physically and economically impossible. (Cole Tr. 547) Such an approach may be suitable for analyzing relative costs in order to identify high cost serving areas -- the original purpose of the BCM -- but it is not relevant to determining actual forward looking costs. (Id.) These costs must be analyzed by examining the long run incremental costs of expanding, maintaining, and replacing the existing network. By analogy, if this state were attempting to determine the tolls necessary to maintain and expand its highway system, it would make that assessment on the basis of a forward looking analysis of the future needs of the existing system. It would not order a study that assumed the highway system would be rebuilt overnight. AT&T has presented

no rationale to support its bizarre approach to analyzing GTE's costs.

c. The Model's Assumptions And Inputs Are Biased To Favor Lower Prices

Even if the underlying approach of the Hatfield Model could be defended, the Model itself could not be. Like any model, the Hatfield Model is only as good as the particular assumptions and inputs that drive it. The Hatfield Model is highly sensitive to fill factors, cost of capital and a number of other inputs. (Mercer Tr. 572-73) As Robert Mercer acknowledged "we have to get those inputs right" for the Model to be reliable. (Mercer Tr. 573)

The evidence in this proceeding establishes that the Hatfield Model has not gotten its key inputs and assumptions right. This is not surprising. Many key inputs are nothing more than the unexplained judgments of Hatfield & Associates or its sole "outside plant expert", John Donovan. (Mercer Tr. 618-19) There is no evidence that any of these judgments are based on an empirical study of any ILEC, much less GTE. (Mercer Tr. 619-21) Predictably, the raw judgments employed by the Model reflect a consistent bias in favor of lower costs and prices.

There are literally hundreds of Hatfield Model default values and it is not possible to address all of them. A review of the more critical values, however, demonstrates the Model's bias and unreliability. For example, with respect to the most important of all inputs, the Model assumes fill factors that are completely out of line with current and projected utilization. Mercer defended his decision to inflate fill factors with the bald assertion that competition will drive fill factors up.

(Mercer Tr. 538) Mercer, who is not an economist, offered no support for this supposition. The evidence is that, if anything, fill factors are likely to decrease in the face of facilities-based competition and other types of alternative providers, as has occurred in the long distance market. Yet, in order to drive cost estimates as low as possible for AT&T, the Hatfield Model cuts spare capacity to the bone, completely ignoring the importance -- reflected in GTE's actual practice -- of maintaining the amount of spare capacity needed for timely, quality service provisioning in GTE’s Washington service area.

The Hatfield Model's assumptions are biased in other respects as well. The Model is static, rather than forward looking, because it ignores demand growth forecasts and input price forecasts. (Cole Tr. 554) For example, the Model fails to calculate net present value over the life cycle of a switch. (Cole Tr. 555) It ignores the fact that the present value of an investment must equal the initial cost of the investment plus the present value of future upgrades. This omission is significant because vendors price switches as loss leaders and achieve their high margins through add-ons once the purchaser has become a captive customer. (Id.) The Hatfield Model does not take this phenomenon adequately into account. (Id.) It foresees only the cost of the initial switch without looking down the road at add-ons. The result, again, is unduly low input prices.

Another serious bias in the Hatfield Model stems from its assumption that other utilities will share the costs of placing feeder, distribution, and interoffice cable. (Cole Tr. 551) The Model arbitrarily assumes that GTE will bear only one-

third of these costs. (Cole Tr. 552) There is no evidence in the record to support that allocation, which obviously has an enormous impact on GTE's projected costs. In fact, the evidence refutes the notion that there will be any meaningful sharing of the costs of underground and buried cable. (Cole Tr. 552)

It is also undisputed that the Model contains "mismatches" of customers and wire centers. (Mercer Tr. 612) Such mismatches mean that the length of feeder and/or distribution cable used in the Model is wrong. Mercer testified that Hatfield & Associates has not conducted a full investigation to correct this problem, and that he cannot say whether or to what extent it exists in Washington. (Mercer Tr. 613-15)

Finally, the Hatfield Model grievously understates GTE's common costs. The Model assumes that GTE's common costs are such that GTE can recover them through an allocation of 10 percent above the company's TELRICs. This means that, in the Model's view, common costs are only 6 or 7 percent of total costs. This assumption apparently is based on Mercer's personal "notion of what a fair share is." (Mercer Tr. 577)[1/] It certainly is not based on any analysis of

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[8/] Elsewhere in the record, AT&T's witnesses claimed that their estimate of common costs was derived from a "compilation" of (a) some sort of regression equation, (b) alleged AT&T data, and (c) studies of the automobile and airline industries. (Mayo Tr. 457; Mercer Tr. 610) No such regression has been supplied in this proceeding and, according to the unrebutted testimony of Dr. Cole, regressions of this nature used in other proceedings are seriously flawed. (Cole Tr. 585) It is obvious, moreover, that studies of other industries are of no relevance to ILECs. (Cole Tr. 566) The ILECs traditionally have been regarded as natural monopolies because of their substantial economies of scope and scale. Even the FCC First Report and Order recognizes the existence of these economies. See Order at ¶ 11. Such economies would not exist if common costs were de minimis, as the Hatfield Model assumes.

GTE in Washington. GTE's common costs are much higher. In fact, as documented below, its common costs are reliably estimated to be at least 33 percent of total costs.

d. The Hatfield Model's Prices Cannot Be Reconciled With The Record

The upshot of the Hatfield Model's biased assumptions is, not surprisingly, ludicrously low prices. In fact, as Donald Perry showed, the Hatfield based prices would enable AT&T to purchase unbundled elements, rebundle them to replicate GTE's basic service, and sell that service at a discount, compared to GTE's retail price, of 77 percent. (Perry Tr. 719) This vastly exceeds the 31 percent wholesale discount rate advocated by AT&T, which, as will be shown below, is itself exorbitant.

Accordingly, one of two things must be true. Either the Hatfield Model has completely failed to produce realistic and fair price estimates or GTE's regulated retail prices are several times higher than they should be. The latter scenario would mean that there has been a total failure of regulation in this state, and that GTE is earning enormous monopoly profits and has tremendous inefficiencies. There is no evidence in the record to support these latter conclusions. It follows that the Hatfield Model -- for all of the reasons set forth above -- does not accurately reflect GTE's costs in Washington.

3. The FCC Proxy Rates Cannot Be Used To Set Prices

AT&T may urge that, if the arbitrator rejects the Hatfield Model, he should set prices based on the proxy rates established by the FCC's First Report and

Order. However, the United States Court of Appeals for the Eighth Circuit has stayed those proxy rates on the ground that their use by a Commission would result in irreparable harm to GTE. Iowa Utilities Board, et al. v. FCC, et al., (Docket No. 96-3321, et al.), Order of October 15, 1996 ("Stay Order") at 18-19.

AT&T may argue that the arbitrator can avoid the effect of the Eighth Circuit's Stay, and can ignore the discredited and inoperative pricing provisions of the Order, through the ruse of referring to those pricing rules as "guides". The arbitrator should reject any such argument and should instead follow the mandate of the Act, which is to set just and reasonable prices based on actual cost evidence in this record. See 47 U.S.C. § 252(d).

Indeed, as noted above, since the pricing provisions of the First Report and Order are not effective, they do not exist for purposes of the arbitrator's determination. Accordingly, the arbitrator cannot impose the very pricing provisions nullified by the Eighth Circuit under the pretext of obtaining guidance from the FCC's First Report and Order. Rather, he must set prices based on the evidence before him. The only probative evidence of GTE's costs is found in GTE's cost studies. Thus, GTE's TELRICs constitute the appropriate starting point for pricing of interconnection and unbundled network elements.

C. GTE's Pricing Proposals Should Be Adopted

Both parties agree that pricing at TELRIC is not appropriate. Something must be added to reflect, at a minimum, GTE's common costs. The reason is obvious and can be illustrated through a simple example. Consider two network elements, each with a TELRIC of $10, and with shared costs between them of

$5. Clearly, the cost to the company of producing the two elements is $25. However, if the two elements were sold separately at their TELRIC prices of $10 each, with no allocation of common costs, the company would realize only $20 and would lose $5 on the transactions. That result would amount to a taking.

Accordingly, AT&T at least purports to include in its pricing proposals a share of GTE's common costs. Unfortunately, though, that share turns out to be reflected in an increase of only 10 percent over TELRIC, per the Hatfield Model. GTE will now show (1) that its common costs vastly exceed what can be captured by a 10 percent increase over TELRIC, (2) that prices must reflect this fact, instead of simply applying the arbitrary 10 percent increase, (3) that prices should be set at market determined levels pursuant to the M-ECPR methodology to promote efficient competition and further the recovery of GTE's common costs, and (4) that AT&T's criticisms of M-ECPR pricing are misguided.

1. GTE's Common Costs Are Substantial

The only probative evidence in this proceeding regarding the actual magnitude of GTE's common costs was presented by GTE. As discussed above, the Hatfield Model's 10 percent common cost allocator is based on an arbitrary "compilation" of unreliable assumptions and claims.

GTE, by contrast, presented two company-specific calculations of its common costs: a top down (or economist's) approach and a bottom up (or accountant's) approach. Both calculations demonstrate that the company's common costs are quite large.

The top down approach begins with GTE's total forward-looking cash flow

-- the total revenues required for the company to remain an ongoing entity. (Doane Tr. 408) From this forward-looking cash flow, one subtracts those costs that are attributable to specific services, i.e., the TSLRICs. (Id.) The remaining costs represent those forward-looking costs that are not attributable to specific services, in other words the company's forward-looking common costs. (Id.)

As Michael Doane explained, GTE's 1995 revenue data provides a reasonable guide for approximating total forward-looking costs. This is true because regulation permits the firm the opportunity to produce a revenue stream that is only just sufficient to replace its depreciated capital over time to cover its current operating expenses. (Doane Tr. 408) As a logical matter, the only grounds for concluding that revenue data is an inappropriate guide would be if (a) revenues included above-normal profits or (b) GTE's costs were not forward looking because they embody outdated technologies and padded costs. (Id.) There is no evidence in the record that would support a claim that the state of Washington has permitted either phenomenon to occur.

As a second method of analysis, GTE presented a bottom up, or accountant's, approach to estimating common costs. This approach looks at those costs in the USOA (Uniform System of Accounts) expense accounts that GTE expects to incur on a forward looking basis that are not included in the TSLRICs. These costs constitute a reasonable estimate of GTE's common costs.

The results of the two methods are remarkably similar. The top down "economist's" estimate shows GTE's common costs in Washington to be

approximately 40 percent of total costs. (Perry Tr. 707) The bottom up "accountant's" estimate shows them to be approximately 33 percent of total costs. (Perry Tr. 708) In order to recover these common costs, prices must be set well above TELRICs. In fact, if the arbitrator were to follow AT&T's approach and employ a fixed, across-the-board allocator to raise prices above TELRICs, that allocator would have to be 50 percent or greater.[1/] The 10 percent fixed allocator arbitrarily selected by AT&T certainly would be inadequate.

[9/] As noted, however, the market would not permit recovery through such an allocator, since some of the prices the allocator produced would exceed market alternatives.

Finally, it should also be noted that AT&T has adduced no evidence that GTE will avoid incurring a single dollar of the costs it has identified as part of its joint and common costs. What is more, AT&T cannot obtain relief by claiming that GTE's joint and common costs are too high. If there are joint and common costs that should have been allocated to specific elements, then the TELRIC for those elements must be increased in direct proportion to any decrease in GTE's common costs. In short, the sum of GTE's TELRICs and joint and common costs is fixed. No fat or monopoly rents have been identified. Accordingly, GTE is entitled to recover all of those costs, either in the form of joint and common costs or through its TELRICs. To the extent that they cannot be recovered through pricing, an end-user charge is necessary.[1/]

[10/] Imposition of an end-user charge is consistent with Section 254(f) of the Act, which requires every telecommunications carrier to contribute on an equitable and nondiscriminatory basis, to universal service. The end user charge, by definition, allows for the recovery of subsidies inherent in the existing rate structure. As such, these subsidies are an element of actual costs for which GTE must be compensated.

2. Prices Must Reflect The Fact That GTE's Common Costs Are Substantial

Both the Act and the Constitution require that GTE be permitted to recover its costs plus a reasonable profit. If GTE were required to sell unbundled elements at prices that do not cover all of GTE's costs associated with those elements, the result would be a taking of GTE's property without just compensation. Thus, in the example discussed above in which two elements have TELRICs of $10 each and common costs of $5, a requirement that GTE sell the elements for only $10 a piece would result in a taking of $5.

AT&T seems to agree that prices should reflect GTE's common costs. In fact, its economic witness, John Mayo, agreed that prices should fully reflect common costs even if it turns out that common costs are greater than the Hatfield Model assumes. (Mayo Tr. 458) As we have seen, AT&T's arbitrary 10 percent fixed allocator for common costs clearly will not be sufficient to recover GTE's common costs. It follows that, even under Dr. Mayo's view, AT&T's approach is inadequate. Indeed, that approach would ensure an unconstitutional taking of GTE's property and lead inevitably to GTE's insolvency. (Doane Tr. 433)

The magnitude of the taking can be illustrated by the following analysis. If we assume that the FCC's proxy rates (which exceed AT&T's prices) were imposed upon GTE, they would generate total revenues for the Company of about $15.4 million.[1/] For the same items -- loops, switching and vertical services

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[11/] This figure was calculated as follows: FCC loop rate of $13.37, plus NID costs of

-- GTE's 1995 revenues were $29.8 million.[1/] The difference between the proxy and current revenues with GTE providing all the services is $14.4 million. In other words, use of the proxies would, in essence, mean almost a 48 percent reduction in GTE's total revenues for those services. The amount of this reduction is staggering and does not even reflect additional revenue losses from switched access, intraLATA toll, and vertical services. This result reflects the fact that the FCC's rates (or, for that matter, AT&T's proposed rates) fail to account for GTE's significant common costs, among other things.

Ultimately, there are only two sources of recovery of GTE's common costs. AT&T and other new entrants can pay for them or they can be recovered from consumers. The merit of recovering common costs from entrants is obvious. A firm's common costs are closely related to its economies of scope. The FCC has stated that part of what it envisions new entrants obtaining from the

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$1.61, plus a port rate of $2.00, plus switching usage of 850 minutes per line/per month x .004 proxy rate (=$3.40), plus 75% of transport interconnection charge (TIC) (=$1.44) for a total of $21.82. This total was then multiplied by 707,130 access lines.

[12/] This figure was calculated as follows: local service charge $22.87 (average rate, including CALC), plus switched access, which includes end-office switching and information surcharge (=$5.77), plus 100% of the TIC (=1.92), plus local switching (=$.45), plus vertical features (=$1.51), plus toll ($9.60), for a total of $42.12. This total figure was then multiplied by 707,130 access lines.

ILECs are the ILEC's economies of scale and scope. See FCC First Report and Order at ¶ 11. There is no reason why the new entrants should not pay for the common costs associated with these benefits. The consumers of Washington should not be asked to subsidize AT&T's entry.

3. M-ECPR Pricing Is The Appropriate Method For Promoting Competition And Recovering Common Costs

The M-ECPR pricing methodology GTE proposes will promote efficient competition and, to a far greater degree than AT&T's proposal, will enable GTE to recover its common costs. M-ECPR pricing introduces a market constraint on prices. It does not allow GTE to charge a price for an unbundled element that exceeds the element's stand-alone cost. Pricing is based on the considerations that govern in a competitive market, namely the nature of market alternatives.

To illustrate the point, consider the M-ECPR price for a loop. The evidence is that the interstate 2-wire special access line is a good substitute for a loop. (Doane Tr. 403)[1/] The stand-alone cost of this element is approximately $30. (Id.) Based on this market-based consideration, the M-ECPR loop price is set at $30. (Id.) This is not a make whole price. (Id.) If GTE established the loop price based on the revenues it would generate from the loop in the absence of competition, the resulting price would be approximately $76 for the average business customer and approximately $47 for the average residential customer.[1/]

[13/] The testimony of Dr. Mayo also establishes the existence of competitive alternatives for transport services and switching. (Mayo Tr. 467-470)

[14/] These represent the ECPR prices, as defined (and properly rejected) by the FCC in

(Doane Tr. 404)

The significantly lower M-ECPR price promotes efficient entry by potential competitors. Contrary to the testimony of Dr. Mayo (Mayo Tr. 343), the fact that the input is priced above TELRIC will neither create barriers to efficient entry nor prevent prices from falling in response to market forces.

The point can be illustrated through a simple example. Assume a "monopoly input" with a TELRIC of $3. Assume further that the remaining cost of retailing a service with that input is also $3 and that the current retail price is $10. In this setting, the M-ECPR price of the input is $7 ($3 for the TELRIC plus $4 for the opportunity cost). Thus, an entrant can obtain the input for $7. If it is as efficient as the incumbent, it can retail the service at $10 and break even, which, according to Dr. Mayo, is exactly what "effectively competitive" firms do in a competitive market. (Mayo Tr. 355) If it is more efficient, it can make an economic profit.[1/]

Significantly, moreover, the entrant can unilaterally reduce the M-ECPR price it pays its competitor by reducing its retail price. For example, if it decides

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its First Report and Order.

[15/] To be sure, a less efficient potential competitor will not be able to break even. However, the parties agree that inefficient entry is neither desirable nor a goal of the Act. (Mayo Tr. 414) Thus, the fact that M-ECPR pricing discourages inefficient entry is another one of its virtues.

to retail the service for $9, then, assuming that consumers are price sensitive, the market price will fall to $9 and the M-ECPR price for the input will fall to $6 ($3 for the TELRIC and $3 for the new opportunity cost). Thus, a reduction in the entrant's price does not produce a reduction in the entrant's profits because the reduction in price produces a corresponding reduction in cost. The efficient entrant, in effect, controls its own destiny. It is free to lower its price to the extent market forces warrant. (Doane Tr. 438-39)

The other half of the equation is recovery of common costs. Here, too, M-ECPR pricing is superior to AT&T's proposed approach. Suppose, for example, that in the hypothetical situation just described the $4 contribution resulting from the $10 price includes $3 for a reasonable allocation of common costs. The M-ECPR price of $7 (and the adjusted M-ECPR price of $6) would enable the incumbent to recover the common costs. AT&T's proposal, under which the input would be priced at $3.30 (TELRIC plus ten percent), would not.

M-ECPR does not, however, guarantee full recovery of forward looking common costs. In the case of the unbundled loop, for example, the price may drop significantly below $30. It is also possible that the $30 price itself does not encompass a reasonable allocation of common costs.

As a result, and because M-ECPR (unlike the version of ECPR rejected by the FCC) does not allow GTE to recover its full opportunity costs, M-ECPR pricing is not make whole pricing. Thus, it will create stranded investment which GTE is entitled to recover, as a matter of constitutional law. GTE proposes that this recovery be accomplished through a competitively neutral end-user charge.

The end-user charge is compelled by the Act itself which permits GTE to recover all its costs. 47 U.S.C. § 252(d)(l).[1/]

[16/] The end-user charge is also mandated by the Eighth Circuit's Stay Order. Indeed, one of the reasons GTE and the ILECs sought a stay was because the forward looking TELRIC methodology "does not consider historical or `embedded' costs (i.e., costs that an incumbent incurred in the past)." (Stay Order at 11) GTE's cost studies are forward looking TELRIC studies, and therefore an end-user charge must be established so that GTE may recover the costs of its past investment.

However, for purposes of pricing unbundled elements, M-ECPR pricing represents the correct approach. It should be adopted by the arbitrator, along with the concrete pricing recommendations that flow from this methodology. Specifically, the unbundled loop should be priced at $30 per line per month applied on a statewide basis.[1/] (Perry Tr. 705) The network interface device should be priced at $1.80 per month, and the unbundled port should be priced at $3.50. (Tr. 706) These rates are consistently at or below TELRIC plus a fixed allocator based on the more conservative "accountant's" estimate of GTE's common costs. (Id.) The remaining pricing proposals generally track GTE's interstate rates. (Id.)

4. AT&T's Criticisms of M-ECPR Pricing Are Without Merit

AT&T, through Dr. Mayo, presented a litany of complaints about the M-ECPR methodology. (Mayo Tr. 376) Most of them have already been addressed. For example, Dr. Mayo is mistaken in claiming that M-ECPR perpetuates monopoly pricing and locks in inefficiencies. There is, of course, no evidence in this proceeding that GTE is permitted by the arbitrator to earn monopoly profits, and Dr. Mayo did not claim that GTE earns such profits. In any case, as discussed above, M-ECPR pricing permits prices to fall in response to efficient entry. Thus, in the example discussed above, to the extent that the incumbent's price of $10 contains an excess (or monopoly) profit, or reflects

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[17/] This price is less than the price derived from TELRIC plus the fixed allocator. As noted, it is also the rate the market has established for the interstate 2-wire special access line, which is physically identical to the unbundled loop.

inefficiencies, an efficient entrant can drive that price down (and reduce the ILEC's monopoly profits) without any reduction in its own profits.

Dr. Mayo's criticism that, under M-ECPR pricing, prices won't decrease as costs become lower is also wide of the mark. As our example has illustrated, decreases in an entrant's costs will enable the entrant to lower its prices in order to capture market share. Moreover, M-ECPR pricing actually permits the entrant to control its own costs. By dropping its price, the entrant lowers the M-ECPR price it pays for its inputs. This is a unique advantage. If General Motors reduces its price for a Chevrolet, its costs do not automatically decrease. Under M-ECPR pricing, however, a CLEC's costs drop in response to decreases in the price it charges.[1/]

Ultimately, Dr. Mayo's testimony appears to be inconsistent with his own writings. Dr. Mayo acknowledges that, under the Act, the prices of unbundled elements shall be based on cost. (Mayo Tr. 340) He then equates this standard to "a marginal cost standard." (Id.) However, in his book, Government and Business, he defines economic cost as including the implicit value of the input, "defined as the opportunity cost of owned resources."[1/] M-ECPR pricing defines

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[18/] It should also be stressed that any claim that M-ECPR was rejected by the FCC is simply false. As explained above, unlike M-ECPR, the theory rejected by the FCC does not allow for the downward adjustment of prices in response to market forces. We have seen that, in the case of the unbundled loop, M-ECPR produces a price that is less than half of the price produced under the version of ECPR rejected by the FCC.

[19/] See Kaserman and Mayo, Government and Business, The Economics of Antitrust and Regulation (Dryden Press, 1995), p. 32. Dr. Mayo testified that only social opportunity costs, not private opportunity costs, should be considered in determining economic cost. However, this is a distinction that appears nowhere in his book and,

economic costs in precisely that way.

III. The Arbitrator Should Adopt GTE's Proposed Avoided Cost Discount For Resale.

A. Overview

Section 252(d)(3) of the Act establishes the standard for calculating wholesale discount rates:

> For the purpose of section 251(c)(4), a State Commission shall determine wholesale rates on the basis of retail rates charged to the subscribers for telecommunications services requested, including the portion thereof attributable to any marketing, billing, collection and other costs that will be avoided by the local exchange carrier.

The wholesale price calculation thus begins with a determination of the ILEC's current retail rate, and subtracts from this rate the costs avoided when a service is offered through a wholesale, rather than a retail, distribution channel. Added to this figure are the extra costs that an ILEC will incur by selling its services at wholesale, rather than retail.

A fundamental tenet of this arbitration, and the due process protections of the Fourteenth Amendment, is that the arbitrator's decision on the proper wholesale rate must be based upon substantial record evidence. A witness cannot simply provide conclusory views regarding what a wholesale rate, avoided

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according to Mr. Doane, has no applicability in this context. (Doane Tr. 394) Dr. Mayo's apparent attempt to compare GTE's profits with those of a drug dealer (Mayo Tr. 417) is too silly to warrant a response.

cost discount, or particular avoided cost factor should be. These views must either be substantiated through record evidence, or ignored. Wholesale discounts cannot be based upon speculation, prophecy, or abstract notions of what rates would be "pro-competitive". Opinions by "experts" must be supported by underlying data and grounded in sound economic methodology. Daubert v. Merrell Dow Pharmaceutical, Inc., 113 S. Ct. 2786, 2795 (1993).

In this proceeding, only GTE has provided probative evidence regarding the costs it will avoid, and the new costs it will incur, by offering its services through wholesale, rather than retail channels. GTE has done this through two cost studies, both of which use a detailed analysis of GTE's work centers to determine what its costs will be in a wholesale environment.

AT&T has taken an entirely different tack. Just as in the case of unbundled network elements, it has ignored evidence specific to GTE and relied on proxy numbers, in this case, those of the FCC. However, to the extent those numbers failed to produce the desired result, AT&T then made various arbitrary adjustments. Perhaps most egregiously, AT&T has elected simply to disregard the new costs GTE will incur, on the bizarre theory that, since the costs cannot be determined with precision, they should be assumed not to exist. Accordingly, as shown in detail below, AT&T's avoided cost study, and the avoided cost discount derived therefrom, should be rejected in favor of GTE's analysis.

B. GTE's Avoided Cost Studies

1. GTE's Original Avoided Cost Study

GTE submitted an Avoided Cost Study which complies with the requirements of the Act by determining the costs "that will be avoided" in a wholesale environment. See 47 U.S.C. § 253(d)(3). As Cynthia Morrell explained, in this study GTE analyzed all of its operations, including all of its work centers, to determine which of its activities in each work center would be avoided when a portion of GTE's business changes from retail to wholesale. (Morrell Tr. 266-67) The total costs for affected activities ("affected costs") were determined from the books and records of each center using GTE's 1995 cost data. (Morrell Tr. 268) The affected costs for each service were calculated on a national basis. (Morrell Tr. 269) This was appropriate because GTE's Washington retail operations are supported by work centers in other locations that also support GTE operations in other states. (Morrell Tr. 269)

Once GTE determined which costs will be avoided, it turned to the second part of the avoided cost equation -- the new costs it will incur as a result of its new role as a wholesaler of local exchange services. (Morrell Tr. 271-72) To accomplish this, GTE looked to its existing wholesale business -- carrier access. It identified and analyzed existing wholesale services similar in nature to those in each of the retail service categories. (Morrell Tr. 272) These accounts were used to estimate the costs of substituted wholesale activities ("substitute costs"). Avoided costs were then calculated by taking affected retail costs and subtracting substitute costs.

GTE's Avoided Cost Study results in avoided costs of $0.83 per line per month for residential services and $1.06 per line per month for business services.

(Morrell Tr. 273) Although the study produced a composite discount of 7%, separate discount percentages were calculated based upon categories of services (7.1% for usage services; 5.5% for business vertical services; 6.6% for residential vertical services; and 15.3% for advanced services). (Id.)

2. GTE's Modified Avoided Cost Study

In response to, and in accordance with, the now-stayed FCC Order, GTE conducted a Modified Avoided Cost Study. (Morrell Tr. 292) In this study, GTE, using FCC ARMIS data, analyzed the extent to which specific expenses will be avoided. (Id.) The FCC, in running the same model, had presumed that expenses in six direct expense accounts will be 90 percent to 100 percent avoided in a wholesale environment.[1/] However, the FCC also made it clear that these presumptions were not based on satisfactory data, and, accordingly, were rebuttable. (FCC Order at ¶ 909).

Based on the same work center cost detail used in its Avoided Cost Study, GTE rebutted the discount factors assumed by the FCC and replaced them with discount factors supported by detailed analysis. The result was an avoided cost discount of 11.81 percent. However, GTE intends this study to be used only in the event that the FCC's rules are held to be lawful. Otherwise, GTE proposes the avoided cost discounts established by its original study.

The discount factors in GTE's Modified Avoided Cost Study are well

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[20/] The six accounts are product management (6611), sales (6612), product advertising (6613), call completion (6621), number services (6622), and customer services (6623).

supported by the evidence. No discount is included for call completion expenses (account 6621) because, even in the wholesale environment, GTE will be required to offer these services in the exact same manner as they are offered today. As Cynthia Morrell testified, GTE's operator expenses are production costs, not retail costs. (Morrell Tr. 277) The costs are the same whether the service is provided retail or wholesale. (Id.) This is true whether or not AT&T also provides operator services. While AT&T chooses to consider these costs "avoidable", they will not be avoided by GTE. The same analysis applies to number services (account 6622). (Morrell Tr. 277)

GTE has also established that substantial expenses in account 6623 -- customer services -- will not be avoided. This account includes carrier access expenses which, undisputedly, will not be avoided. (Morrell Tr. 277)[1/] It also includes service ordering expenses. It can hardly be disputed that GTE will continue to incur expenses when services are ordered from new entrants such as AT&T. AT&T asserts that there will be efficiencies associated with billing carriers instead of end-users. (Dodds Tr. 248) But even if this unsupported assumption were true, it hardly supports AT&T's assumption that GTE will incur no costs in this account.

GTE has also shown that product management costs (account 6611) will not substantially be avoided. Even if it exited the retail market entirely, GTE surely would continue to improve its existing products and develop new ones in

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[21/] The same is true for accounts 6611, 6612, and 6613. (Id.)

order to succeed as a wholesaler in the long run. (Morrell Tr. 276) The Telecommunications Act does not contemplate the withering away of GTE's network. This means that GTE will continue to incur the expenses associated with managing its products, including the design and roll out of new products.

Sales and advertising expenses (accounts 6612 and 6613) will be largely avoided, but not entirely avoided, as AT&T assumes. GTE will face competition even as a wholesaler, and this will entail some advertising. (Morrell Tr. 276) Sales expenses likewise will be incurred to some extent, the same way they are incurred now when GTE services AT&T in the context of its carrier line of business.

C. AT&T's Avoided Cost Study

AT&T advocates an avoided cost discount of 31.23 percent. (Dodds Tr. 255) It generates this inflated figure through a series of sleights of hand. First, it assumes that costs in the six direct expense accounts discussed above will be 100 percent avoided even though it concedes that, at least for some of the accounts, this assumption is not true. (Dodds Tr. 247) In addition, while purporting to follow the methodology of the FCC (Tr. 239), AT&T abandons that methodology in crucial respects in order to raise the discount rate.

First, where the FCC used 90 percent discount factors in most of the six direct expense accounts -- including account 6623 which is by far the largest -- AT&T elected to deem the expenses in all six accounts 100 percent avoidable. (Dodds Tr. 256) Second, while the FCC considered uncollectibles avoided only to the extent that indirect expenses are avoided, AT&T arbitrarily assumed them

to be 100 percent avoided. (Id.) Third, where the FCC found that plant testing and administration expenses are not avoided, AT&T treats them as 20 percent avoided. (Id.) Fourth, AT&T arbitrarily excluded only operator expenses, not operator revenues, from its avoided cost equation. (Dodds Tr. 248, 255)

These departures alone caused an increase in the avoided cost discount of about 8 percentage points. (Dodds Tr. 256) In addition, AT&T's unfounded assumptions about which direct expenses will be avoided affected its calculation of the indirect expenses that will be avoided, since it treats indirect expenses as avoided in proportion to direct expenses. (Dodds Tr. 250) Its analysis of indirect expenses was further distorted by computing indirect avoided costs in proportion to direct expenses, which is contrary to the FCC's approach. (Dodds Tr. 280)

D. GTE's Proposed Avoided Cost Discount Must Be Chosen Over AT&T's Proposal

The foregoing discussion of the methodologies used by AT&T and GTE should convince the arbitrator to adopt GTE's proposed discount. AT&T's proposed discount of 31.23 percent is based on a series of assumptions and manipulations that cannot be supported by the Act or the evidence in the record.

First, AT&T's proposal is based, albeit loosely, on the FCC's methodology set forth in the First Report and Order. However, the pricing provisions of that Order have been stayed and no longer are in effect. Thus, there is a complete failure of proof on AT&T's part, since it has failed to base its analysis upon any approved methodology. GTE's Avoided Cost Study therefore constitutes the only viable evidence of the appropriate avoided cost discount in this arbitration.

Second, AT&T's study is a theoretical study of "avoidable" costs. As noted, it is based on assumptions about what costs GTE might avoid, rather than on analysis of what costs will be avoided. The Act, however, provides that wholesale rates shall be determined "on the basis of retail rates charged to subscribers . . . 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) (emphasis added). Congress' use of the word "will" rather than "could" conclusively establishes that wholesale rates must be set based on the ILECs avoided, not "avoidable", costs.

Third, AT&T relies exclusively on broad ARMIS account data. These accounts do not contain any information regarding GTE's work centers or its actual activities, through which a rational avoided cost discount could be derived. Without an analysis of that information, AT&T's conclusions regarding the extent to which expenses in various accounts will be avoided are pure speculation.

Fourth, the testimony confirmed that AT&T's avoided costs factors were unsupported and unrealistic. Astonishingly, AT&T has decided to simply ignore the costs GTE will incur as a wholesaler. As its witness, Ms. Dodds, testified, "we have not at this point in the model assumed any cost onsets", i.e., "new or existing wholesale costs." (Dodds Tr. 245)

AT&T excludes these costs from consideration not because it denies they exist. On the contrary, it admits, for example, that GTE will incur customer expenses in the wholesale context. (Dodds Tr. 247) AT&T's rationale, rather, is that (a) it cannot determine the type or extent of these costs and (b) "there's been

no determination of how those costs should be borne". (Tr. 245)

These arguments are specious. The fact that the extent of GTE's cost "onsets" necessarily must be estimated (since the exercise involves forecasting the effects of something that has not yet occurred) is hardly a basis for assuming there will be no onsets. The one thing both parties agree on is that there will be some. GTE has presented a reliable forecast of what they will be, based on its experience as a wholesaler of access services. AT&T has had this information since July 1996. (Morrell Tr. 273)

Moreover, contrary to AT&T's claim, there is no genuine dispute about how the costs that GTE incurs servicing CLECs should be treated. Even the FCC agreed that these costs must be factored into the avoided cost discount. This treatment follows inexorably from the principle of cost causation which AT&T purports to embrace. (Doane Tr. 390) To the extent AT&T demands that GTE sell it services wholesale, AT&T causes GTE to incur whatever costs this entails. As Michael Doane explained, unless AT&T bears those costs, it will receive a subsidy. (Id.)

AT&T's handling of other issues is similarly high handed. For example, AT&T has presented no evidence that GTE will be able to do less testing of the network merely because it is a wholesaler. As Cynthia Morrell explained, GTE will be required to provide the same quality service to AT&T as it does to end users. (Morell Tr. 278) Indeed, AT&T is seeking penalties to the extent GTE fails to do so. In order to provide the required level of service, GTE will have to test the network, just as it does now. (Id.) It is also arbitrary for AT&T to assume

that GTE will have no uncollectibles as a wholesaler. There is no evidence to support that view, which is contrary to its present experiences as wholesaler.

In contrast to AT&T's approach, GTE's studies are tied to data from its work centers, including data regarding GTE's actual experiences as a wholesaler of access services. GTE's work center cost data is reliable. Cynthia Morrell testified that GTE's work center costs tie directly to the ARMIS reports. This information is frequently audited. (Morrell Tr. 294) In fact, the state of Washington recently scrutinized GTE's work center costs. (Id.) Thus, the arbitrator should use the avoided cost discount derived from GTE's original study. Alternatively, if it embraces an FCC style approach, over GTE's objection, the arbitrator should use the results of GTE's modified study.

IV. The Act and the Eighth Circuit Order Make Clear The Requirement that the Arbitrator Apply GTE's Economic and Cost Evidence, and the Act Provides Ample Time for Such Consideration.

A. Sequence and Timing

Although the time pressures that the Act imposes on the arbitrator are substantial, a thoughtful consideration of the cost and price issues in light of the Stay Order is necessary in order to reach a just and reasonable result. Also, the nine month deadline imposed by the Act applies only to the resolution of issues contained in the Petition, not to execution and approval of the contracts themselves.

The Eighth Circuit's ruling does not alter the arbitrator's statutory charge to

adjudicate the dispute between the parties in this arbitration. As explained above, the arbitrator must interpret the Act and state law to determine "just and reasonable" rates for interconnection.

Nevertheless, the arbitrator is not now required to, and need not, undertake the task of directing contractual provisions between GTE and AT&T. He need only address the core, disputed issues of this arbitration. To review and attempt to merge contract drafts as part of the arbitration decision would be a daunting and unnecessary task for the arbitrator to undertake at this stage of the statutory process.[1/]

Congress provided for the arbitrator to resolve issues within 9 months of the filing of the CLEC's request for interconnection and, in doing so, meet the requirements of and implement Section 252(c) of the Act:

> (C) The State commission shall resolve each issue set forth in the petition and the response, if any, by imposing appropriate conditions as required to implement subsection [252](c) upon the parties to the agreement, and shall conclude the resolution of any unresolved issues not later than 9 months after the date on which the local exchange carrier received the request under this section.

Act § 252(b)(4)(C). The arbitrator is not expected, and is not required, to resolve all terms and conditions needed to implement interconnection between the

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[22]The level of contractual detail varies by subject within the draft agreements and the contract strategy of the supporting company. GTE's draft sets forth with reasonable specificity the terms and conditions of the arrangements. AT&T, however, presented substantially more verbose provisions and, quite frankly, approached the level of detail of an operations manual in many areas. The arbitrator would be hard pressed to square these two documents.

parties within the 3 ½ to 4 ½ month period between the filing of the arbitration and the required decision. This is stated clearly in Section 252(c) of the Act:

> (c) STANDARDS FOR ARBITRATION - In resolving by arbitration under subsection (b) any open issues and imposing conditions upon the parties to the agreement, a State commission shall-
>
> (1) ensure that such resolution and conditions meet the requirements of section 251, including the regulations prescribed by the arbitrator pursuant to section 251;
>
> (2) establish any rates for interconnection, services, or network elements according to subsection (d); and
>
> (3) <u>provide a schedule for implementation of the terms and conditions by the parties to the agreement</u>. (emphasis added).

The "schedule for implementation of the terms and conditions" includes the finalization of the agreement by the parties once the arbitration decision is rendered on the core issues. This is part of the schedule to be determined by the arbitrator in the order that must be issued within the 9 month statutory time limit.

Moreover, most of the contractual language differences between the parties are not "issue[s] set forth in the petition and the response" as contemplated in Section 252 (b)(4)(C). The Petition of AT&T included its proposed contract and, likewise, GTE's Response included its proposed contract. But these draft contracts were not intended to identify "issues" for the arbitrator in the sense of needing to arbitrate specific language differences between the parties or to choose between competing provisions. Instead, the parties asked for resolution of the core "issues" and, recognizing the significance and scope of

these issues, they understood that the contract itself would be negotiated after the decision in the arbitration were issued. This is fully consistent with the arbitrator's imposition of terms and conditions to implement its decision on an appropriate schedule.

Once the parties have concluded the contract that implements the arbitrator's arbitral decisions, they must submit it to the Commission for final approval. Section 252(c)(4) then allows the Commission 30 days to approve or reject the contract. This provision would be superfluous if Congress had intended for the contract itself, in addition to the disputed issues subject to arbitration, to be concluded and blessed by the arbitrator within the nine month period prescribed by Section 252(c).

This result has been already formally adopted in other states. In Virginia, for example, the State Corporation Commission expressly separated the arbitration decision, which must be rendered in 9 months, from the contract finalization that will occur thereafter:

> Section C. Agreement arrived at through compulsory arbitration
>
> * * *
>
> 6. Nine months or sooner after the request for interconnection services or network elements was received by the incumbent local exchange company, the arbitrator shall issue a decision resolving the unresolved issues. In its order, the arbitrator shall provide a deadline for the parties to the negotiation to provide the arbitrator with a formalized agreement.[1/] (emphasis added).

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[23]Procedural Rules for Implementing §§ 251 and 252 of the Telecommunications Act of 1996, 47 U.S.C. §§ 251, 252, Order Adopting Rules,

Clearly, such a logical and time-insensitive approach should be adopted here as it would allow the arbitrator to focus specifically on the critical issues within this mandated abbreviated schedule and to leave to the parties the detailed drafting of implementing language in the contract.

The Act does not require the arbitrator initially to order (in effect, write) an exhaustive, detailed contract. Rather, the Act requires the arbitrator to resolve "open issues" -- the type of issues set forth in the parties joint matrix. Section 252(b)(4). The arbitrator cannot fairly or lawfully impose the entirety of one party's proposed contract on the other without carefully analyzing each clause and provisions. Otherwise he may inadvertently impose obligations inconsistent with his resolution of open issues, or otherwise create unintended problems. Certainly, GTE has over the last several weeks devoted the considerable efforts of dozens of people in addressing the open issues which the arbitrator can resolve based on the hearing evidence, rather than performing a detailed analysis of AT&T's 600 page proposed contract.[1/] The finalization of hundreds of pages of contract language is more properly a follow on activity to implement the arbitrator's decision pursuant to a prescribed schedule.

Case No. PUC960059 (Va. SCC, July 31, 1996).

[24] AT&T's proposed contract is close in size to GTE's entire cost study submission (GTE 9).

Additionally, the arbitrator should direct that GTE's proposed agreement be the base contract in which his decisions are ultimately memorialized. In addition to the virtue of relative brevity, GTE's proposed agreement provides a significant administrative benefit of consistent form, format and general content. This is the same agreement being proposed by GTE Northwest and other GTE companies in each of their several arbitrations with AT&T and other companies across their multistate service areas. Clearly GTE will be best able efficiently to implement these agreements under the Act if they are as consistent as possible from state to state. Also, much of the administration of such agreements will be performed by regional and national departments and workgroups, and they will obviously function best with standardized agreements.

As to an implementation schedule for the performance of the duties set forth in the contract, the appropriate dates and time frames are many and various; a number of them are conditional on actions by AT&T and other companies, and some may depend on the technical and operational aspects of the issue resolutions order by the arbitrator. GTE should, for example, be in a position to receive and process straight forward orders for unbundled loops fairly soon after the agreement is finalized. On the other hand, operational support system activities will depend on the actions of outside vendors, as well as AT&T. For example, the parties' Pennsylvania arbitrator has issued a recommended decision which declines to set a date certain by which GTE should present AT&T the final cost estimates for the work AT&T wants GTE to do to modify OSS, because, before such cost estimates can be given, AT&T must determine what

proprietary interfaces it wishes to develop or a national industry standard must be developed. The same time restraints would apply to any other portions of the arbitrator's order where GTE's response is dependent upon information outside of GTE's control, such as specific AT&T requests, technological evolution, or industry developments.

B. The Arbitrator Should Adopt GTE's Rates On An Interim Basis

GTE is mindful of the burdens the Act's arbitration timetable imposes on the arbitrator and the parties, and is not opposed to the arbitrator adopting interim rates until it has an opportunity to consider fully the cost and pricing evidence introduced in this proceeding. Therefore, if the arbitrator determines that it needs more time to examine the evidence, GTE proposes that the arbitrator adopt GTE's rates on an interim basis subject to a "true up" mechanism.

Use of GTE's rates will avoid the significant constitutional issues raised by the FCC's proxy rates and the Hatfield Model proxy rates. As discussed previously, the Court of Appeals has stayed implementation of the FCC's proxy rates on the grounds that such rates will irreparably harm GTE by imposing economic losses "that [GTE] would be unable to fully recover." (Stay Order at 18). The imposition of such losses would amount to a takings under the Fifth Amendment. See, e.g., Brooks-Scanlon Co. v. Railroad Comm'n, 251 U.S. 396 (1920). Accordingly, the FCC's rates are invalid for all purposes, including use by the arbitrator on an interim basis, and this same rule applies to the other proxy

rates advanced by AT&T.

In contrast to AT&T's proposed rates, GTE's rates reflect its actual costs. Therefore, using GTE's rates on an interim basis subject to true-up avoids the constitutional infirmities inherent in the FCC proxy rates or the Hatfield Model proxy rates. For all these reasons, and for all the reasons discussed in this brief, GTE respectfully requests that the arbitrator adopt GTE's rates on either a permanent or interim basis.

GTE is aware, of course, that the Commission has determined "that a generic pricing proceeding should be initiated in order to conduct a full and fair review of the cost studies proposed" in the various arbitrations pending before the Commission.[1/] GTE supports such an effort, provided it has a firm legal and jurisdictional basis and that GTE's proposed prices are used in the interim.[1/] Therefore, if the arbitrator chooses to follow an interim rate approach, a condition of his decision and the contract should be that rates will be trued up in a follow on proceeding conducted in accordance with the Act.

[25/] Order on Sprint's Petition to Intervene and to Establish Generic Pricing Proceeding, Dockets No. UT-960307, etc. (Oct. 23, 1996).

[26/] As GTE will further explore with the Commission when that docket is opened, even if the Commission has state law authority and jurisdiction to conduct such a proceeding, it should also be expressly grounded in the Act.

V. MATRIX ISSUES

This section of the Brief discusses the 69 open issues identified in the parties' joint matrix. Given the scope of this proceeding, however, GTE cannot discuss all of the reasons supporting all of its positions in this Brief. Therefore, GTE incorporates by reference all of the testimony, cost studies and exhibits it presented in this arbitration.

Resale/Avoided Cost Issues

Issue #1 - What is the proper methodology for determining the prices for GTE resold services?

GTE Contract Provision - The proper methodology is reflected in GTE's Avoided Cost Study. Appendix E to GTE's proposed contract sets forth GTE's proposed resale prices.

GTE's Position - GTE's Avoided Cost Study complies with the Act. AT&T's "study" does not.

Discussion - This issue is discussed in section III of this brief. Subissues are discussed briefly below.

Issue 1A: Are advertising expenses in their entirety an avoided cost?

No. GTE will continue to incur advertising expenses while provisioning resold services for AT&T. Moreover, GTE has incurred advertising expenses in other wholesale markets in which it operates, and AT&T offers no evidence to the contrary. Rather, it relies solely on the stayed FCC rule that advertising costs are

presumed avoided. The Act requires wholesale costs for resale services to reflect costs that "will be avoided." Consequently, GTE is entitled to recover the advertising costs that it will continue to incur when AT&T resells GTE services.

Issue 1B: Are call completion costs (operator services) in their entirety an avoided cost?

No. Call completion costs are not included in the rates of any of the resold services and, therefore, will not be avoided by GTE in a wholesale environment.

Issue 1C: Are number service costs (directory assistance) in their entirety an avoided cost?

No. GTE will still incur directory assistance costs when providing services to a CLEC, and therefore is entitled to recover the costs that reasonably will be incurred in the provision of resold services.

Issue 1D: Are general and administrative expenses an avoided cost when GTE is wholesaling a local service?

No. General and administrative expenses are not an avoided cost. General and administrative expenses are not avoided entirely in a wholesale environment. GTE is entitled to recovery of general and administrative costs which will be incurred in the provision of resold services.

Issue 1E: Are product management costs in their entirety an avoided cost?

No. Product management expenses are not avoided, since product planning, product development and product roll-out activities among others, are required regardless of whether products are offered at retail or wholesale.

Issue 1F: What percentage of testing and plant administration costs are an avoided cost?

Testing and plant administration costs are not an avoided cost. GTE will continue to be required to engage in testing and plant administration for services offered at resale. AT&T's estimate that "approximately 20% of GTE's customer related testing costs can reasonably be avoided" is not substantiated in the record. Moreover, as GTE witness Morrell explained, GTE must provide testing of resold services in order to meet the requirement that it provide the same quality of service to AT&T end-users that it provides to its own end-users.

Issue 1G: What percentage of sales expense are avoided?

GTE's avoided cost study demonstrates that only sales expenses that are related to consumer and business sales will be avoided. Thus, it is appropriate to consider only such actually avoided expenses.

Issue 1H: What percentage of uncollectible expenses are avoided?

GTE's avoided cost study established that none of its uncollectible expenses will be avoided in a resale environment. AT&T contends, again relying on the stayed FCC rules, that all uncollectible expenses relating to wholesale services sold to AT&T are avoidable. The proof, however, is to the contrary. GTE has always experienced uncollectibles on AT&T's account as an interexchange carrier customer. Thus, it is reasonable and appropriate to calculate uncollectible expenses as 100% not avoided.

Issue 1I: Does the Act's methodology for determining wholesale rates recognize any new costs that might be caused by the requirement to offer services for resale?

Yes. The Act requires that GTE recover all of its costs. GTE's avoided cost study establishes that GTE will incur additional costs as a result of making

services available for resale.

AT&T agrees that GTE will incur new wholesaling costs. AT&T witness Dodds admits, however, that no compensation is offered to GTE for these costs in AT&T's simplified avoided cost study. Requiring GTE to undertake activities (e.g., billing services) without receiving any compensation is impermissible under both the federal and state constitutions. See, e.g., Brooks-Scanlon Co. v. Railroad Comm'n, 251 U.S. 369 (1920). In addition, the FCC's First Report and Order, upon which AT&T rests its case, recognizes that "some new expenses may be incurred in addressing the needs of resellers as customers" (¶ 928), and properly allows for recovery of such costs. For example, the FCC recognized that incumbent LECs may incur wholesale costs "in complying with their request for unbranding and rebranding," and directed state commissions to assess these costs and permit their recovery. (¶ 971) Therefore, GTE is entitled to offset its wholesale discounts to reflect any additional wholesaling costs.[1/]

As discussed in Issue 1 above, GTE's "net avoided costs" methodology accounts for the additional wholesaling costs, and GTE's methodology and

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[27]Although the FCC specifically mentions branding, GTE's avoided cost study does not account for additional branding costs or any other one-time cost required to implement resale, such as electronic interfaces. We cite to the FCC's "branding" discussion only to stress that additional costs will be realized in a wholesale environment and that incumbent LECs are entitled to recover these costs.

resultant studies are supported by the record.

Issue 1J: Is a volume discount appropriate in a resale environment, and if so, what should the discount be?

A volume discount is not appropriate. The Act does not require or discuss any such discount. Moreover, there is no evidence that GTE will avoid any additional costs simply because of AT&T's volume requirements (assuming, of course, these volume requirements are not entirely speculative).

Section 252(d)(3) provides that wholesale rates are to be based on an incumbent LEC's retail rate minus the LEC's avoided costs. There is no mention of a "volume discount." Therefore, any arbitrary reduction for "volume requirements" would be contrary to the express language of the Act.

AT&T's suggestion that paragraph 860 of the First Report and Order supports volume discounts is misplaced. This paragraph does not state that discounts must be awarded. To the contrary, it provides that "price differences, such as volume and term discounts, when based upon legitimate variations in cost are permissible under the 1996 Act, if justified." (emphasis added). AT&T has not provided any evidence of "legitimate variations in cost," nor has it provided any evidence showing that such variations are "justified." Consequently, no volume discounts are appropriate.

Issue #9 - What GTE services should be required to be made available for resale at wholesale rates?

GTE Contract Provision - See generally Article V (including 5.1, 5.2, 5.5, 5.6,

5.7) and Appendix E.

GTE's Position - GTE will offer for resale, at a discount, all of the services currently available at retail, except those categories which would undermine the long-term competitive objectives of the Act.

Discussion - Section 252(c)(4) of the Act only requires that incumbent LECs not to impose “unreasonable or nondiscriminatory conditions or limitations” on the resale of telecommunications services. Thus, the Act plainly recognizes that incumbent LECs may impose reasonable conditions and limitations on resale. The First Report and Order also recognizes that ILECs may impose resale restrictions. (¶ 939, 51.613(b)) The two limitations on resale requested by GTE are both reasonable and non-discriminatory as explained below.

a. Below-cost Services

For these purposes, GTE’s only below-cost service is local residential (R1) service. Because this service is already sold at rates below the cost of providing it, a further discount of those rates would be unjustified and unconstitutionally confiscatory. Today, GTE’s below-cost services receive contribution from other services – such as toll, access and vertical services – that are priced above their incremental costs. If GTE were forced to resell below-cost service to CLECs at a discount, the CLECs would (1) obtain avoided-cost discounts for both below-cost and above-cost services; and (2) pocket the contributions from the above-cost services that subsidize below-cost services. Accordingly, GTE cannot recover its total costs unless below-cost services are excluded from its wholesale offerings

or are re-priced to cover their costs. Any other result would be contrary to the Act's emphasis on the ILECs' entitlement to recover their costs of providing services to CLECs. (GTE 10.36).

Allowing CLECs to buy services below their economic costs would be a powerful disincentive to the Act's ultimate goal -- development of facilities-based competition. A rational company will never build its own facilities if it can continue to obtain services below the costs it would incur to provide them itself.

b. Promotions

There is no pro-competitive reason for GTE to offer any promotions at a discount. When GTE sells a service for resale, the CLEC sets its retail price for that service. It can, if it chooses, reduce its customary retail price to offer customers a promotional discount, just at GTE does. Thus, a CLEC will be able to fully compete with GTE – just as it competes with any other CLEC – on a promotional basis without the windfall of an additional discount rate off the already reduced promotional rate. If the arbitrator does not restrict resale of promotions, GTE will never be able to distinguish its offerings from those of its competitors. Every time GTE offers a reduced promotional price, the CLEC will be able to undercut GTE's price on the same promotion – not because of the CLEC's competitive efficiency, but simply because of an artificially imposed price

structure[1/]. GTE thus will have no incentive to offer creative promotions, some of which may last longer than 90 days. This result is contrary to the interests of Washington consumers. (GTE 10.34-35).

GTE asks only for the same degree of flexibility its competitors have. The evidence disproves AT&T's contentions that this equitable treatment will prompt GTE to shift consumers to perpetually discounted, nonstandard offerings if the arbitrator accepts GTE's position. To this end, GTE has demonstrated its good intentions by agreeing to the resale of discount calling plans.

c. Services to the Disabled

All social programs mandated by law that provide special rates are the responsibility of the carrier serving a particular customer. The serving carrier should bear the responsibility of (I) ensuring that its customers are eligible to receive the benefits of any social program, and (ii) bearing the cost of such programs. The same reasoning that supports GTE's position regarding below-cost services supports this position. Until such rates for these below-cost services are rebalanced, GTE cannot offer them at wholesale discounts.

d. Advance Notification of New Services

AT&T wants 45 days advance notice of new services, over the 30 days now required in Washington (see RCW 80.36.110). GTE often does not finalize tariff filings until virtually the day before filing with the Commission. The arbitrator should not impose an arbitrary straight jacket on the company.

[28/] Or the CLEC might simply pocket the price reduction.

Issue #10 - Should GTE be required to offer for resale at wholesale rates services to the disabled, including special features of that service such as free directory assistance service calls, if that service is provided by GTE?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - This issue is discussed in Issue #9.

Issue #11 - What resale restrictions should be permitted, if any?

GTE Contract Provision - Article V 2.2, 2.3, 5.5, 5.6, 5.7.

GTE's Position - In addition to those restrictions discussed in Issue #9, AT&T should be prohibited from "cross-class selling."

Discussion - AT&T may only resell services to that class of customer obtaining identical services from GTE. As a simple example, AT&T (or other CLECs) should not be permitted to sell residential service to business customers. The Arbitrator may impose these restrictions because they are not only reasonable and nondiscriminatory, see 47 CFR §51.613, but also mandated by the Act.

With this restriction, fair competition will develop because one carrier will not be able to artificially undercut the price of another carrier. (See generally First Report and Order ¶ 959 ("There is a . . . consensus that resale of Lifeline service should be limited to those eligible to receive such service from the incumbent LEC")).

Similarly, grandfathered services (which are ILEC services offered only to a limited group of customers who subscribed to such a service in the past)

should be offered at wholesale rates to requesting carriers for resale only to the same limited group of customers. (GTE 10.35-36.)

Issue #13 - Should GTE be required to offer public pay phone lines to AT&T at wholesale rates?

GTE Contract Provision - Article V 5.7.

GTE's Position - No.

Discussion - Section 251(c)(4) of the Act requires GTE to offer for resale at wholesale rates any telecommunications service "that it provides at retail to subscribers who are not telecommunications carriers." GTE does not provide public pay phone lines or service at retail to subscribers; therefore, the resale of public pay phone lines and services is not required under the Act. AT&T has provided no compelling reason why this obligation should be imposed upon GTE.

To the extent AT&T is requesting a service or element not required by the Act, the arbitrator must refuse to require GTE to provide such service or element. The AT&T arbitrations are brought under § 252 of the Act. Section 251(c) sets forth the standards state commissions are required to apply, and this section requires state commissions to resolve any open issues or impose any conditions that "meet the requirements of § 251." Section 251(c) sets forth the duties of incumbent LECs, and requires them to negotiate in good faith "the particular terms and conditions of agreements <u>to fulfill the duties described in [§ 251(b)] and this subsection</u> (emphasis added). Thus, under the plain language of the

statute, incumbent LECs need not negotiate terms and conditions that fall outside the duties set forth in § 251(b) and (c), and arbitrators and commissions cannot compel incumbent LECs to do so.

Issue #14 - Should GTE be required to offer semi-public pay phone lines to AT&T at wholesale rates?

GTE Contract Provision - No specific contract provision exists; compare Article V 5.7.

GTE's Position - No.

Discussion - This service has been deregulated by the FCC and is no longer offered to subscribers at retail under GTE's local exchange tariffs. <u>See</u> FCC's Order in CC Docket 96-388, at ¶ 142. GTE's analysis in Issue #13 applies here.

Issue #15 - Should GTE be required to offer COCOT coin and COCOT coinless lines to AT&T at wholesale rates?

GTE Contract Provision - Article V 5.7.

GTE's Position - No. GTE will offer these services, but there will be no wholesale discount.

Discussion - Here again, GTE already provides COCOT coin and coinless line services under terms of applicable tariffs, and there is no additional "wholesale discount."

Issue #16 - Should each and every retail rate have a corresponding wholesale rate?

GTE Contract Provision- No specific contract provision exists.

GTE's Position - No. Only those retail services that are offered at resale should have a corresponding wholesale rate.

Discussion - This issue is identical to Issue #9. Nevertheless, retail and wholesale service rates should be structured similarly. For example, the costs of below-cost services should be rebalanced before these services are offered on a wholesale basis. Note also, that the FCC's First Report and Order does not require the same resale discount for all services. See also response to Issue #9.

Unbundling/Interconnection

Issue #3 - How should the cost of interconnection and unbundled network elements be calculated, and what prices should be established?

GTE Contract Provision - Article IV 3.3.1; Article IV 4.2.3.

GTE's Position - The costs should be calculated based on GTE's cost studies, which reflect GTE's costs rather than the costs of some hypothetical network. For this same reason, the Commission should adopt GTE's prices, which are based on GTE's cost studies and which include a reasonable share of GTE's common costs. This issue is discussed in detail in Section II of this brief.

Issue #4 - What rates are appropriate for transport and termination of local traffic?

GTE Contract Provision - Article VI 3.3.

GTE's Position - The appropriate rates to be charged by GTE are those set forth in GTE's interstate access tariff.

Discussion - The rates referenced in GTE's interstate access tariff are just and reasonable and are consistent with GTE's M-ECPR methodology which, as we have already discussed, is consistent with the Act. (GTE 7.4)

Any rates that AT&T could charge to GTE cannot be determined at this time, because AT&T has not submitted any cost study. Moreover, symmetrical pricing is not warranted. (AT&T's prices likely will be lower than GTE's). Accordingly, AT&T should be directed to submit its own cost study so that the Arbitrator can establish the prices GTE must pay for transport and termination.

Issue #17 - Should GTE be required to route operator services and directory assistance calls to AT&T's platforms where AT&T purchases resold services under § 251 (c) (4) of the Act or state law?

GTE Contract Provision - Article V 5.9, 5.10.

GTE's Position - No. The Act does not require GTE to change its retail services for AT&T's benefit. State law is not at issue on this point in this arbitration.

Discussion - Section 251(c)(4) of the Act requires GTE to offer for resale, at wholesale rates, telecommunications services "that it provides at retail to subscribers who are not telecommunications carriers." This provision of the Act - by itself - resolves this issue. When AT&T resells a GTE retail service, it buys

and receives the same service that GTE's retail customers do, according to tariff. The only difference is that AT&T buys the service at a "wholesale" rate.

GTE does not provide operator service or directory assistance call routing "at retail to subscribers who are not telecommunications carriers." Rather, GTE's basic local service includes routing of operator and directory assistance calls to GTE's operators. Accordingly, when AT&T buys that tariffed service for resale, it obtains such routing to GTE's operators.[1/] Of course, AT&T is free to offer its customers the opportunity to dial up AT&T's operators (e.g., by dialing "00") and AT&T's directory assistance center.

In complying with the Act, GTE has agreed to provide those aspects of operator services and directory assistance that it currently offers at retail along with its local service offering at the appropriate avoided cost standard. This proposal conforms with the Act and GTE should not be required to do more.

Issue #18 - Should GTE be required to route operator services and directory assistance calls to AT&T's platforms where AT&T purchases unbundled network elements under § 251 (c) (3) of the Act or state law?

GTE Contract Provision - Article VI 5.2.

GTE's Position - No, not as AT&T has demanded it. The customized routing to

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[29/] GTE may be interested in negotiating further with AT&T to create new services for AT&T to resell, but such a negotiation would be outside the scope of the Act and arbitrations conducted under it.

AT&T's platforms of operator services and directory assistance calls desired by AT&T is not currently available. On an interim basis, GTE is willing to make available to AT&T the routing capability GTE presently has, provided AT&T complies with certain conditions, including paying all costs.

Discussion - AT&T has asked GTE to unbundle its switch so that AT&T can route its customers to AT&T's operator services (OS) and directory assistance (DA) platforms, with dedicated trunk groups linked to any interexchange carrier (IXC) AT&T designates. AT&T apparently believes such unbundling is technically feasible because GTE switches already provide this capacity on orders from GTE's own service centers. AT&T misunderstands the nature of the service provisioning and activation process.

GTE's testimony shows that current switch limitations would require GTE to add new switch capacity and to condition its existing switches in order to provide customized routing. More specifically, to provide this routing, GTE would be required to install separate trunk groups to route calls to AT&T's platforms, and unique line class codes would have to be assigned to the lines of AT&T's customers in order to "tag" the calls so that the switch recognizes those calls that must be routed to AT&T's trunk groups. (GTE 13.12, 20-23; Peelman Tr. 69-72).

Because GTE has different types and generations of switches, this issue must be addressed on a case-by-case basis. Moreover, AT&T has not indicated which switches it wants available for customized routing, or when it desires this capability. As a result, GTE cannot at this time calculate the costs of customized routing. To do so, GTE would need to know, for example, the number of routing

possibilities AT&T wants for each switch and the number of different routing options AT&T wishes to make available to its customers. GTE believes it is unreasonable to impose what may be unnecessary burdens upon incumbent LECs. Moreover, AT&T must bear the attendant costs. (First Report and Order ¶ 199).

There may be different approaches to resolving switch issues, depending on the switches involved. Ultimately a long-term solution is needed. Any long-term routing solution likely will require the development of industry standards from which equipment manufacturers, such as Lucent, can design and build products. Because such standards do not yet exist, AT&T's proposed solution would require GTE to first alter its existing switches, then undo those modifications when a permanent solution is found. GTE should not be expected to reallocate its limited resources to such a futile task. Further, there is no evidence in the record that would allow the Arbitrator to set an implementation schedule. (GTE 13. 20-24).

In balancing the interests of the parties, GTE will agree to provide customized routing as an unbundled offering (as opposed to a modification of a resold retail service) on an interim, short-term basis (e.g., using line class codes on a nondiscriminatory basis where available) upon the following terms and conditions: (1) AT&T shall submit reasonable requests and identify those geographic areas where it wants customized routing; (2) within a reasonable time after receiving AT&T's notification, GTE will identify its switches serving in the designated area and advise AT&T whether customized routing is technically

feasible for those switches; (3) if customized routing is technically feasible, GTE will make such routing available within a reasonable time period; (4) AT&T shall pay all the costs associated with its selective routing request; and (5) the parties will work to establish a long-term industry solution. (Unbranding of GTE services is also an option for AT&T. See Issue 21).

Issue #19 - Should GTE be required to provide access to its directory assistance database so that AT&T may provide its customers with AT&T-branded directory assistance?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - No. It is not technically feasible for GTE to provide third party on-line access to its directory assistance (DA) database at this time. It is GTE's intention to provide as an ultimate long term solution, an electronic gateway offering whereby CLECs may access GTE's directory assistance listings and will be charged actual measured usage on a per event, query, or transactional basis. As an interim offering, GTE has offered to provide to AT&T its directory assistance listings on magnetic tape.

Discussion - The evidence shows that it is not technically feasible for GTE to provide third party access to its DA database at this time. Serious problems arise when multiple users have access to a secured database. A gateway and other measures are necessary to safeguard the security and integrity of the data. At this time, there are no vendor endorsed, industry accepted solutions to this

problem. (GTE 13. 23-24).

Once the technical issues are resolved, the costs associated with development, deployment and ongoing operation must be identified. These costs are difficult to estimate, but no will doubt be significant. Whatever the eventual costs may be, they should be paid for by AT&T (or other parties requesting access) because it, and not GTE, will benefit from the access. Paragraph 199 of the FCC's Order is clear on this point:

> Of course a requesting carrier that wishes a 'technically feasible' but expensive interconnection would, pursuant to section 252(d)(1), be required to bear the cost of that interconnection, including a reasonable profit.

To impose any of these costs on GTE would result in an unconstitutional taking of GTE's property.

Until such time as the gateways and firewalls necessary to provide third party access have been developed and deployed, GTE has agreed to provide AT&T with its directory assistance listings on magnetic tape. GTE also will provide daily updated listings on magnetic tape daily. Initial load, update, and assumed usage cost for processing and distribution will be charged to AT&T. GTE offers to license the usage of its listings solely for the purpose of local directory assistance.

Issue #20 - Should GTE be required to provide directory listing information to AT&T via electronic data transfer on a daily basis so that AT&T may update its directory assistance database and provide its customers with AT&T-branded

directory assistance?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - See discussion under Issue #19.

Discussion - See discussion under Issue #19.

Issue #21 - Should GTE be required to accommodate AT&T's branding requests concerning operator services and directory assistance?

GTE Contract Provision - Article VII 5

GTE's Position - No. The Act does not include such a requirement for either resold retail services or unbundled network elements.

Discussion - As discussed with regard to Issue 17, insofar as AT&T's request relates to resold retail services, the Act does not obligate GTE to change its services for AT&T's benefit. AT&T buys and resells GTE's retail service "as-is." No "restriction on resale" is involved with this issue. In any event, significant network, operational and cost issues would be presented, and AT&T makes no offer to compensate GTE for them.

If and when customized routing is available on a broad scale, GTE agrees to brand on behalf of any CLEC. In the interim, GTE has offered to unbrand its directory assistance services in a resale environment for use by AT&T (where it is lawful to do so), and AT&T has accepted this offer.

Issue #30 - What unbundled network elements should be provided to AT&T?

GTE Contract Provision - Article VI.

GTE's Position - GTE will unbundle the NID, loop, port, transport, and its signaling systems. It also will provide access to OSS functions. It will consider additional unbundling requests, such as technically feasible sub-loop unbundling, on a case-by-case basis. GTE's willingness in this regard is conditioned upon AT&T's agreement to certain terms and conditions.

Discussion - Based upon the testimony of AT&T's technical witnesses, it appears that general agreement exists on this issue, as well as many other aspects of unbundling. Each aspect is briefly addressed below.

Network Interface Device (NID) - GTE will permit AT&T to connect its loops directly to GTE's NID, provided that such interconnection does not adversely affect the reliability and security of GTE's network. (GTE 13.13-14).

Loop Distribution, Loop Feeder and Loop Concentrator/Multiplexer. - Taken together, these items constitute a local loop, which GTE is willing to unbundle where it is technically feasible to do so.[1/] See id. at 14-15. Providing these items separately is really "sub-loop unbundling," which is discussed in Issue 33.

Local Switching. - See Issue 34.

[30/] As Mr. Peelman explained, full loop unbundling generally should be technically feasible. There may be some situations where necessary equipment and facilities do not exist. (Tr. 49, 50, 52, 60.) If it is technically feasible to add such equipment and facilities and AT&T is willing to cover the costs, GTE will negotiate a resolution to such requests.

Dedicated Transport, Common Transport. See Issue 40.

Signaling Link Transport, Signal Transfer Points (STPs), Service Control Points/Databases (SCPs). See Issues 37 and 38.

Directory Assistance Service. Directory Assistance Service obviously is not a network element subject to unbundling under the Act. DA Service is not "transmission" under the Act. See Act §§ 153 (47). However, to the extent GTE has tariffed directory assistance services, AT&T may order such services.

Advanced Intelligent Network (AIN) Capabilities. See Issues 35 and 36.

* * *

The elements listed above will enable AT&T to compete effectively in the local exchange marketplace. The hearing established that unbundled loops will be of the most interest to AT&T, as AT&T already has switches and additional switching capacity is readily available from manufacturers (including recent AT&T affiliates Lucent Technologies and AGCS) and other carriers already in the Washington market. However, in all cases GTE's agreement to provide these unbundled elements is dependent on AT&T's willingness to agree to certain conditions which are necessary to preserve the integrity of the network and ensure that GTE recovers costs as required by the Act. Specifically, AT&T must (1) notify GTE when it intends to deploy any service-enhancing copper cable technology (e.g., HDSL, ISDN) and, if so, certify that such technology will not interfere with GTE's existing or future technology within a given cable sheath or

other GTE facility;[1] and (2) pay all the costs associated with unbundling the loop from the switch, including the costs of testing AT&T's technology and the costs of any loop conditioning.

Issue #31 - To what extent should AT&T be permitted to combine network elements?

GTE Contract Provision - Article VI 2.3, 2.3.3.

GTE's Position - AT&T may combine unbundled elements with any services or facilities that AT&T itself may provide, so long as AT&T does not combine unbundled network elements purchased from GTE to bypass resale offerings.

Discussion - If AT&T were to purchase unbundled elements and then recombine those network elements, it would be able to avoid access charges, and replicate GTE's resale offerings, thereby creating an opportunity for arbitrage in contravention of the Act.

Issue #32 - Should AT&T be permitted to request a combination of network elements which would enable it to replicate services GTE offers for resale?

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[31] See GTE 12.7 and Peelman Tr. 63-65 regarding the necessity of GTE receiving NCI codes in order to protect the integrity of other services in the same cable as unbundled loops used by AT&T.

GTE Contract Provision - Article VI 2.3.3.

GTE's Position - No. AT&T cannot reassemble network elements to avoid taking resale offerings.

Discussion - The Act's pricing standards for unbundled elements and services offered for resale are deliberately different. AT&T wishes to create arbitrage opportunities that would eviscerate the Act's unambiguous distinction between unbundled elements and wholesale services. AT&T should not be permitted to avoid the mandated resale pricing standards by recombining unbundled elements into a service equivalent to a wholesale offering.

Under the Act, rates for unbundled elements are generally cost-based, whereas rates for resold services are based on avoided costs. Compare § 252((d)(1)(A) (unbundled element pricing) with § 252(d)(3) (resale pricing). Based on this distinction, AT&T has identified an arbitrage opportunity that could provide it with a substantial windfall. Specifically, it seeks permission to take and then recombine unbundled elements in any manner it wishes, allowing it to replicate resold services. For instance, it would likely purchase unbundled loop and port services in combination at unbundled rates to avoid buying basic local service for resale. Buying unbundled elements rather than wholesale offerings will allow AT&T, in some cases, to obtain the same result, but for much less money.

This proposal would render meaningless the Act's distinction between unbundled elements and resale and the associated, respective pricing standards

and provide AT&T with an unfair advantage not envisioned by the Act. Neither Congress nor the FCC intended to encourage this sort of tariff arbitrage.

Issue #33 - Is sub-loop unbundling technically feasible, and if so, under what terms and conditions should it be offered?

GTE Contract Provision -Article VI 4.8.

GTE's Position - Sub-loop unbundling may be technically feasible in some circumstances, and should be offered on a case-by-case basis for those network configurations where it may be technically feasible, with AT&T paying all associated costs.

Decision - At the hearing, the parties were essentially in agreement on this issue. While the FCC has not required GTE to unbundle its sub-loops, GTE has agreed to address requests for sub-loop unbundling on a case-by-case basis. This -- rather than a company wide implementation of such unbundling -- is the appropriate way to proceed because sub-loop unbundling is not technically feasible in all instances. Since there is no standard network configuration, the technical feasibility of such unbundling will depend on the manner in which each particular loop is configured. GTE’s witness Mike Peelman detailed those instances where sub-loop unbundling is not technically feasible (e.g., cable fed loops), and those circumstances where sub-loop unbundling may be technically feasible (e.g., where cross-connects are employed), subject to factors such as equipment capacity and right-of-way availability. (Tr. 48-63). AT&T concurred

with Mr. Peelman's presentation on this point. (Bohling Tr. 81).

Also, GTE may incur additional costs in providing such unbundling. As such, GTE is willing to provide a sub-loop unbundling as long as all technical requirements are met and GTE receives adequate compensation. In addition, GTE must retain control of its network facilities, and care must be taken to assure that safety measures are taken by AT&T (e.g., electrical grounding and surge protection). (GTE 12.3-4; GTE 13.17-20; Peelman Tr. 43, 48-63,76)

Issue #34 - What should the unbundled switch element include?

GTE Contract Provision - Article VI 5.

GTE's Position - The unbundled local switch element should be the port, which is the line card and associated peripheral equipment on a GTE end office switch that serves as the hardware termination for the customer's exchange service on that switch.

Discussion - The port generates dial tone and provides the customer a pathway into the public switched telecommunications network. The port does not include all the switching and other capabilities ("vertical features") in the switch.[1/] The vertical switch features are services, not elements, and therefore need not be unbundled under the Act.

AT&T's request that it be provided with all of the features and

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[32/] This provides AT&T with access to any features on the switch which GTE uses. To the extent that a switch may have capabilities which GTE does not use, and has not purchased from the switch manufacturer, those capabilities could only be provisioned if

functionalities of the switch at all times is both unreasonable and prohibitively expensive. Since a switch is not designed to allow for complete and total access to all of its capabilities at all times, complying with AT&T's request would be prohibitively expensive. GTE would need to completely re-engineer its switches and it is doubtful that a switch exists that would meet AT&T's requests. Of course, AT&T is not willing to pay the price for this substantial switch re-engineering nor does AT&T require such a switch in order to compete effectively and completely as a local exchange carrier.

GTE has offered two alternatives in order to meet AT&T's request for the unbundled switching element. First, a "port and resale services" option which would provide AT&T with access to all local switching elements through the purchase of GTE's unbundled "line-side" port element. GTE would charge AT&T separately at resale rates for minutes-of-use switched and vertical services. Alternatively, AT&T can pay monthly (and associated non-recurring charges) for the unbundled port and unbundled switch features, along with a local per-minute-of-use switching charge. (Perry Tr. 731; See, GTE proposed contract, Appendix F, sheets F-A and F-B)

Issue #39 - Should AT&T have access to GTE's unused transmission media ("dark fiber")?

GTE Contract Provision - No specific contract provision exists on this issue.

AT&T paid the associated costs. (See, e.g., Peelman Tr. 34-36)

GTE's Position - No. “Dark fiber” is not a network element.

Discussion - The Act defines "network element" to include only those facilities that are "used in the provision of a telecommunications service." Act, § 153(45) (emphasis added). GTE and other carriers do not "use" dark fiber in their networks--transport circuits must be "lit" to be used to provide telecommunications service. Because dark fiber does not meet the statutory definition of a network element, it is not subject to unbundling. See 47 U.S.C. §153(29); 251(c). The FCC has not required ILECs to make dark fiber available. This distinction reflects sound policy, considering the important role of dark fiber in GTE’s network.

As unused equipment, dark fiber is similar to cable stored on a reel in a warehouse. It has been placed in the ground at a given time only because it makes better economic sense to do so from a network planning and construction cost perspective. Allowing other parties to take advantage of GTE’s placement of spare cable disrupts its planning process, thereby raising its costs. GTE prudently deploys fiber to meet its customers’ needs over a reasonable planning horizon. Compelling GTE to hand over fiber to AT&T so that AT&T might provide a DS1 private line would deprive GTE of the ability to serve thousands of other customers. It would also fragment GTE’s network and strand significant investments. (GTE 12.8-9; Peelman Tr. 66)

Even if the Act had compelled ILECs to make dark fiber available, important operational and technical feasibility concerns would call for restrictions

and special handling procedures. Due to fiber's high capacity, damage to it can have very serious customer impacts. In addition, fiber is very sensitive and easily damaged. Thus, GTE would have to have full control of any AT&T connections to dark fiber, and those connections would have to be made at points in the network which minimized the risk to customer service. AT&T would have to cover the extra costs of these necessary precautions and additional maintenance requirements. (GTE 12.9-10; Peelman Tr. 66-68) Also, if access were to be mandated, AT&T recognizes the need to further negotiate the issue, so as to not unfairly impact GTE's provisioning for new service. (Bohling Tr. 111-114)

Issue #40- Should GTE be required to provide both dedicated and common local transport to AT&T on an unbundled basis?

GTE Contract Provision - Article IV 6.

GTE's Position - GTE will provide dedicated transport as a single item and make it available to AT&T through GTE's access tariff. In addition, GTE will make common transport available to AT&T through GTE's access tariff.

Discussion - These services are already available under tariff; AT&T already is purchasing them. The Act does not require that they be relabeled "network elements" just so AT&T can receive a discount. The only discounts to which AT&T is entitled under the Act are for resold retail services. Access services are not retail services.

Issue #41 - Are operator systems (i.e.; GTE-provided Operator Services and Directory Assistance) separate network elements that GTE should be required to unbundle?

GTE Contract Provision - Article VII 5.

GTE's Position - No. <u>See</u> Issues # 17, #18 and #19.

Issue #42 - What are the appropriate interconnection points for the transport and termination of traffic?

GTE Contract Provision - Article IV 4, 5.

GTE's Position - Standard interconnection sites should be mid-span meet points located within GTE's service area, GTE end offices, GTE access tandem offices.

Discussion - Under the Act, interconnection can take place only at points where it is technically feasible. See 47 USC § 251(c)(2)(B). To this end, many factors may frustrate or even prevent interconnection, including incompatibility between CLEC and ILEC equipment; too many CLECs desiring interconnection at a given point; the inability of ILEC switching and transport equipment to handle additional traffic; the unavailability of collocation space. These factors demonstrate that technical feasibility should not be presumed (and interconnection mandated) just because one carrier may have already interconnected at a given point. This point is recognized in the FCC's Order, which states that interconnection at a particular point using particular facilities is only "substantial evidence" of technical feasibility at that point or at "substantially similar points in networks employing substantially similar facilities." See Order, ¶ 204. Thus, interconnection cannot occur at any point and in whatever manner a CLEC wants. The requested point must be substantially similar and employ substantially similar facilities to an existing interconnection, and even then the requested interconnection is not presumptively feasible. (GTE 14.3-4, 8-9, 11-15).

With this need for flexibility in mind, however, GTE contends that AT&T's interconnection needs may be met fully at GTE end offices and access tandem offices, as well as mid-span meet point locations within GTE's service territory.

Issue #43 - Should GTE be required to provide tandem-to-tandem switching for the purpose of terminating AT&T local and intraLATA toll traffic?

GTE Contract Provision - Article IV 3.5

GTE's Position - Yes, provided necessary billing arrangements are made.

Discussion - GTE agrees to provide tandem switching if AT&T interconnects at the GTE tandem, but will not provide tandem-to-tandem switching until such time as (1) AT&T has entered into one of the existing intraLATA toll compensation mechanisms (e.g., ITAC, as involved in GTE's primary toll carrier case[1/]); or (2) signaling and AMA record standards support the recognition of multiple tandem switching events. In this way, the parties can ensure proper billing for inter-tandem switching. (GTE 14.15-17)

Default Proxies

Issue #2 - Should the Arbitrator adopt the FCC's "default proxy" rates?

GTE Contract Provision - No contract provision relates to the FCC default proxy rates.

GTE's Position - No. As discussed above, the Eighth Circuit has stayed the operation and effect of the FCC's default proxy rates and every portion of the FCC's pricing rules.

[33/] UT-921465, etc. See pp. 15-16 of the Third Supplemental Order , where the Commission approved such an an inter-company compensation process in order to make sure access charges are properly billed and collected.

Parity/Quality

Issue #26 - Should GTE be required to provide dialing parity through presubscription, and if so on what schedule?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - Yes, but the arbitrator need not resolve this issue.

Discussion - GTE is already offering intraLATA dialing parity by tariff in Washington. There is no need to separately address that issue in this arbitration.

Issue #27 - Should the contract include terms which require GTE to provide resold services, unbundled network elements, ancillary functions and interconnection on terms that are at least equal to those that GTE uses to provide such services and facilities to itself?

GTE Contract Provision - Article IV 10; Article V 2.1, 4.1; Article VI 2.4, 11.7, 13; Article VIII 1., Appendix G.

GTE's Position - No special contract provisions beyond those proposed by GTE are warranted or needed.

Discussion - There is no reason for a special contract mandate on this issue. GTE agrees to provide service to CLECs in a nondiscriminatory manner according to the quality levels that GTE provides in the normal course of business. (GTE 24.32-34)

This issue appears to mix two points. The first is whether GTE is required

to provide interconnection, resold services, and unbundled elements to CLECs at the same quality standards that apply to GTE's own services, including its internal planning. The second is whether, in the course of providing nondiscriminatory services, GTE must implement processes (such as access to OSS) on a basis that treats AT&T better than GTE treats itself, whenever AT&T requests it.

The first matter, concerning standards, should not be considered an issue for resolution in this arbitration. GTE has already agreed to provide service quality to CLECs that is nondiscriminatory and equal to that which GTE provides to itself and its affiliates. With regard to resold services, AT&T will be in the same position as any of GTE's customers. With regard to unbundled network elements, GTE will provision and maintain service in accord with its normal operation. (GTE 24.32-33) Any specific disputes which may arise regarding actual service delivery will be addressed by the contract dispute resolution procedure.

Section 251(c) of the Act sets forth the obligations of incumbent LECs, including the interconnection, unbundling, and resale obligations. With respect to interconnection, the Act imposes the duty upon incumbent LECs to provide interconnection "that is at least equal in quality to that provided by the local exchange carrier to itself or to any subsidiary, affiliate, or any other party to which the carrier provides interconnection." This "equal in quality" language appears only in the Act's provisions governing interconnection; it does not appear in the Act's unbundling and resale provisions. Under well-settled principles of statutory

construction, the arbitrator must not read into a statute any provision that is conspicuously absent, especially a provision that appears in another statute only a few sentences away from the statute in question.

Furthermore, existing networks were built to accommodate only one carrier, and alterations to networks will be required to accommodate other carriers. The costs of such accommodations, however, should be borne by the particular cost-causer, not GTE. See §252(d)(I). Thus, to the extent modifications to GTE's network are necessary to meet AT&T's requirements, and assuming GTE is obligated to make them, AT&T must pay for such modifications.

Issue #28 - Must GTE deploy its resale and unbundled offerings in specific time frames, with service guarantees, and provide for remedial measures for substandard performance?

GTE Contract Provision - Article V 2.1, 4.1; Article VI 2.4, 11.7, 13, 14.1; Article VIII 1, Appendix G.

GTE's Position - No. Special conditions are not warranted or needed.

Discussion - This is similar to the previous issue. GTE is required to provide services on a non-discriminatory basis, and will do so. But "service guarantees" are not required under the Act (either for resold retail services or unbundled network elements), and AT&T has not explained how GTE would recover the costs associated with such guarantees. GTE’s prices do not reflect the additional expense of insuring AT&T’s services.

GTE must deploy its resale and unbundled offerings in a reasonable period of time. But given the uncertain and unquantifiable demands upon GTE personnel and GTE's existing network, it is unreasonable to impose specific time frames and service guarantees.

This issue appears to be a "standard of care" issue -- AT&T wants to hold GTE to a standard of strict liability and, in essence, insure AT&T for any perceived losses. Such a result is not required by the Act.

Number Portability Issues

Issue #6 - What method should be used to price interim number portability ("INP") and what specific rates, if any, should be set for GTE?

GTE Contract Provision - Article IV 7; Appendix D.

GTE's Position - GTE’s current tariff offerings are sufficient.

Discussion - The arbitrator need not and should not entertain this issue. The Commission has previously ordered GTE to provide remote call forwarding INP by tariff, which the company is now doing. (GTE 25.2) The Commission continues to supervise GTE’s pricing of that offering in Docket No. UT-941464, etc.

All INP methods impose costs on service providers, such as GTE. (GTE 26.13-14) Therefore, the arbitrator should not impose additional methods of INP where no realistic need for them exists. However, if the arbitrator chooses to revisit the pricing of GTE’s current offerings, or if any additional methods are mandated, the pricing of and rates for INP should be determined according to GTE's pricing and costing methods. (GTE 7.38)

The Act requires that the cost of number portability be borne by all telecommunications providers on a competitively neutral basis. 47 U.S.C. § 251(e)(2). The FCC's Number Portability Order[1/] defined the costs of INP as the “incremental costs incurred by a LEC to transfer numbers initially and to subsequently forward calls to new service providers using RCF, Flex-DID or other comparable measures.” See Number Portability Order ¶ 129. The FCC further provided that states may require tariffs for INP measures. GTE has such tariffs in this state. Since the Commission continues to monitor the pricing of INP

[34/] *In re Telephone Number Portability, First Report and Order and Further Notice of Proposed Rulemaking*, CC Docket No. 95-116, FCC 96-286 (released July 2, 1996) (*Number Portability Order*).

in Docket No. UT-941464, there is no need for the pricing issue to be revisited in this action.

AT&T's proposal that the companies each bear their own costs is a plain attempt to place the entire burden on GTE. AT&T did not demonstrate that it would bear any costs when GTE provides it INP. On the contrary, it is uncontraverted that GTE's network will bear the burden of INP and GTE will incur the costs. (Perry Tr. 723-24) AT&T's proposal is neither competitively neutral nor constitutional and must, therefore, be rejected.

Issue #48 - What methods of interim number portability should GTE be required to provide?

GTE Contract Provision - Article IV 7.

GTE's Position - GTE's current tariff offering is sufficient.

Discussion - The record before the arbitrator establishes no basis for ordering GTE to provide INP methods in addition to that currently available under tariff per order of the Commission. A long term solution to number portability is imminent; AT&T's claim of a need for additional INP methodologies is speculative, and the methods proposed by AT&T would cause significant cost and operational difficulties.[1/] (GTE 26.7-14; Noeker Tr. 158-164)

LERG Reassignment in particular is an impractical proposal for this

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[35/] GTE is generally willing to provide DID INP, but, as the Commission found, the existing tariffed method meets AT&T's needs.

arbitration. In its prefiled testimony, AT&T halfheartedly asked for LERG Reassignment as a method of number portability. LERG Reassignment is not, however, a method of number portability. Rather, it is a change to the industry standard for number routing. Any marginal benefit LERG Reassignment might offer cannot justify the massive changes to network standards that this particular method requires. See GTE 26.10-13. Moreover, since LERG Reassignment requires that every carrier implement the change on an industry-wide basis, the arbitrator cannot order it . His order in this matter would not bind the other carriers across the country who would have to cooperate in its implementation.

The parties agree that their common ultimate goal is a long-term solution. Therefore, to prevent a waste of resources, the FCC required that methods of INP be both technically feasible and currently available. The FCC made the requirement of current availability clear when it stated, "Congress intended that currently available number portability measures be provided until a long-term number portability method is technically feasible and available." Id. ¶ 111 (emphasis added).[1/]

This policy is not merely rhetoric; it makes practical sense, and the FCC already has applied it and rejected a "medium term" database solution that, while

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[36/] See also Number Portability Order ¶ 121 ("[D]eployment of long term number portability should begin no later than October 1997, so *currently available* number portability arrangements . . . should be in place for a relatively short period.") (emphasis added); id. ¶ 122 (using the term "currently available"); id. ¶ 129 (same).

technically feasible, would have required a significant additional investment of resources and time to implement. In rejecting that solution, the FCC stated that "[t]he increased costs of implementing this approach are unwarranted given the imminent implementation of a long-term solution that meets our criteria. In addition, devoting resources to implement a medium-term database solution, which is currently not available, may delay implementation of a long-term database solution." Number Portability Order ¶ 116.

Finally, AT&T has offered only speculation to support its argument for additional methodologies. Therefore, GTE's current tariff offering of remote call forwarding for INP should be adopted as fully consistent with the Act.

Poles, Conduits, Ducts, and Rights-of-Way Issues

Issue #8 - What is the proper way to charge for access to poles, conduits, and rights-of-way?

GTE Contract Provision - Article X; Appendix I 11; Appendix J 12.

GTE's Position - Current contract provisions should be applied until the FCC promulgates further rules.

Discussion - As a fundamental matter, there is no "proper way" to charge for access to poles, conduits, and rights-of-way (collectively, "rights-of-way") because the Act's requirement that utilities grant access to their facilities constitutes an unconstitutional taking of private property for public use without just compensation. (GTE 22.5) Whether the FCC's prescribed methodology for determining the rates for access allows GTE to recoup its costs is irrelevant to

the amount of just compensation. Rather, it is the value of the property that matters, determined by what willing parties would agree to pay and accept in cash. See GTE's Response to AT&T's Arbitration Petition, Report X, "Takings," 15-16, n.7.

Without waiving the above assertion, GTE states that the rates for access to rights-of-way are governed by section 224 of the Act. This section sets forth a formula the FCC must implement for determining rates, but permits states to take jurisdiction over (and set rates for) attachments. Accordingly, rates should be governed by state law or state tariffs where appropriate.

In the absence of state regulation, rates should be governed by the federal law. The FCC, however, has not yet implemented regulations under section 224. See FCC Order ¶ 1215. GTE's position before the FCC will be the same as it is here: to the extent section 224 mandates access, GTE must recover the fair market value of the property taken. This is the only compensation standard that comports with Washington and federal constitutional law. Accordingly, GTE proposes that whatever rates are set should be subject to a "true up," once a lawful rate is established.

Issue #55 - Should AT&T have access to GTE's poles, ducts, conduits, and rights-of-way at parity with GTE?

GTE Contract Provision - Article X.

GTE's Position - No. The Act does not strip GTE of its property rights.

Discussion - While GTE will allow other companies access to its poles, ducts, and rights-of-way, it should not be precluded from reasonably limiting that access. Section 224(f)(1) requires "nondiscriminatory access," but does not require that GTE, as an owner of poles and conduits, be relegated to the status of a mere licensee occupant. Rather, "nondiscriminatory access" requires that an owner of poles or conduits treat equally all companies seeking access. For example, an owner would not be permitted to provide access to a subsidiary or on affiliate on terms and conditions more favorable than those offered to other companies. Similarly, an owner would not be allowed to place more onerous conditions for access on a competitor than are imposed on a noncompeting company.

Notably, the Act applies the nondiscrimination requirement only to those for whom access must be "provide[d]." Section 224 (f)(1) ("A utility shall provide a cable television system or any telecommunications carrier nondiscriminatory access to any pole, duct, conduit or right-of-way owned or controlled by it." (Emphasis added)). Nothing in the section indicates that this nondiscrimination requirement necessarily must apply to the owner, whose "access" is synonymous with its ownership right. And while the FCC has defined the term "nondiscriminatory" differently, see Order ¶ 1170, the arbitrator need not follow the FCC's definition of this term, particularly when interference with the ownership of GTE's property is at stake.

Issue #56 - Does the term "rights-of-way" in section 224 of the Act include all possible pathways for communicating with the end-user?

GTE Contract Provision - Article X.

GTE's Position - No. The Act contains no such requirement.

Discussion - AT&T mixes collocation and unbundled element situations into a new verbal invention: "pathways." (Bohling Tr. 116-117) In its Petition, AT&T refers to "pathways" without adequately defining the term, merely insisting that GTE should be required to share "pathways."

As AT&T has acknowledged, GTE generally does not own or control certain pieces of the "pathway," such as cable vaults, entrance facilities, equipment rooms and telephone closets. Thus, this issue should not arise with regard to these "pieces." (GTE 22.9)

In those instances where GTE does own or control "pathway" equipment, however, the Act does not require GTE to permit access to it, because such equipment is not within the scope of the term "rights-of-way" as used in section 224. The term "rights-of-way" has been in general usage in the industry for many years and included in section 224 since that statute's enactment in 1978. The term never has been interpreted to include equipment for communicating with the end-user. Rather, it simply has referred to streets, roads and other land over which telephone companies are entitled to place their facilities under either statutory grants or privately obtained easements and licenses. "Rights-of-way" does not refer to the poles, cables, vaults, equipment rooms, or other physical

items themselves. The term should continue to be construed in accord with this common, everyday meaning - not AT&T’s overreaching invention. (GTE 22.8-9)

Issue #57 - May GTE reserve space for its future use on/in its poles, ducts, conduits, and rights-of-way?

GTE Contract Provision - Article X.

GTE's Position - Yes. The Act does not strip GTE of its property rights. As an owner of poles, ducts, and rights-of-way, GTE is entitled to reserve space in them for its future use.

Discussion - If GTE were not allowed to make this use of its property, it would suffer a taking under the Fifth Amendment. A determination precluding GTE from reserving space for its own future needs is squarely at odds with the plain meaning of section 224(f)(1), which applies the nondiscrimination requirement only to those for whom access must be "provided," not to the owner, whose "access" is synonymous with its ownership right.

AT&T has cited the FCC's Order as preventing GTE from reserving space for future needs. Specifically, the Order states that nondiscriminatory access required by the Act means that an ILEC cannot reserve space for itself on its own facilities, as doing so "would favor the future needs of the [ILEC] over the current needs of the new LEC." Order ¶ 1170.

AT&T's reliance is misplaced. First, GTE's reservation of space would not prohibit or have the effect of prohibiting AT&T from entering the market.

Accordingly, the language AT&T relies on does not apply. Second, GTE should have the right to reserve space consistent with the Act, GTE's rights as property owner, and its obligations as a carrier of last resort.

As a public policy matter, ILECs, such as GTE, have special service obligations by virtue of their status as providers of last resort. AT&T and other CLECs do not share similar obligations. Therefore, they are free to pick and choose the customers to whom they will provide service. In fact, it is highly likely that they will offer service in only selected areas to maximize the return on their investment. GTE, on the other hand, must be able to serve new customers readily, and therefore always must have reserve capacity. Depriving GTE of the ability to maintain reserve capacity would impair service to the public and cause extraordinary cost increases. (GTE 22.11)

Moreover, depriving GTE of the ability to reserve space on its own property will have a significant adverse effect on GTE's future investment in poles and conduits. If GTE cannot reserve space in its own facilities, it has no incentive to construct facilities sufficient to satisfy future needs. As a result, economic and efficient investments will be lost, and long-range strategic planning rendered impossible. (Id.) The Act should not be interpreted as requiring a result so clearly at odds with the goal of continued investment in public communications networks.

Issue #58 - Is GTE required to make additional capacity available to AT&T, for poles, ducts, conduits, and rights-of-way if GTE does not have spare capacity, and if so, in what time frame should GTE make such capacity available?

GTE Contract Provision - Article X.

GTE's Position - No. This issue is almost identical to Issue 54.

Discussion - Here, as with Issue 54, GTE should not be required to expand its existing capacity to accommodate the needs of AT&T or other requesting carriers. The FCC properly found that "any utility may take into account issues of capacity, safety, reliability and engineering when considering attachment requests, provided such assessment is done in a nondiscriminatory manner." Order ¶ 1176.

<u>Operational Support Services (OSS)</u>

Issue #23 - How should PIC changes be made for AT&T's local customers and should GTE identify PIC charges separately?

GTE Contract Provision - Appendix G 1.2.16.

GTE's Position - GTE will turn back IXC PIC change requests for AT&T customers.

Discussion - GTE considers this issue resolved. GTE agrees that as soon as the necessary changes to its system are completed (targeted for January 1, 1997), it will begin rejecting any requests for PIC changes from IXCs for AT&T's customers, thereby allowing AT&T to request the PIC changes for customers AT&T is serving through GTE resold services or with GTE local switching. (Cox

Tr. 190-191; GTE 32.3). GTE will accept the Local Service Request (LSR) form, rather than the simplified change form demanded by AT&T, or the existing mechanized process originally suggested by GTE. GTE promotes the LSR form as a standard for a variety of transactions, which will benefit both companies.

Issue #24 - What authorization is required for the provision of customer account information to AT&T?

GTE Contract Provision - Appendix G 1.2.2.

GTE's Position - Signed customer permission is required by law and good business practice.

Discussion - In accordance with section 222(c) of the Act, it is GTE's position that, absent a letter of authorization ("LOA") signed by the customer, AT&T may not be permitted to access GTE or other CLEC customer record information in GTE databases or to have customer accounts transferred "as is" since this would reveal customer proprietary network information ("CPNI").[1/] (GTE 24.37-39)

[37/] This issue does not address long distance primary interexchange carrier ("PIC") changes, only local service changes. This issue also does not address the situation where the customer does not currently have local service with either GTE or a CLEC, since there are no preexisting CPNI records which could be compromised.

AT&T's proposal is that it be allowed to perform "self-certification" that the customer has actually requested to change local carriers from GTE to AT&T "as is" *and* authorized AT&T to obtain his CPNI from GTE. In this scenario, the customer would never actually authorize GTE's release of CPNI. Rather, GTE would be required to rely upon AT&T's "self-certification" of such authorization.[1/] Quite obviously, such a procedure invites the very abuses that Section 222(c)'s requirement for written permission from the customer was designed to counteract.

> In Section 222(c) use of customer proprietary information (CPNI) by telecommunications carriers is limited, except as provided by law or *with the approval of the customer*. Subsection (c) specifies that telecommunications carriers shall only use, *disclose or permit access* to individually identifiable CPNI in its provision of services necessary to or used in the provision of such telecommunications service, including directory services. The conferees also agreed upon a provision [Section 222(c)(2)] that will require disclosure of CPNI by a telecommunications carrier *upon affirmative written request by the customer*, to any party designated by the customer.

[38/] AT&T is currently being investigated by the FCC for its "slamming" practices in the long distance market; *see In re AT&T Corp.*, *Notice of Apparent Liability for Forfeiture*, DA 96-48, 11 FCC Rcd 1885 (released January 23, 1996). GTE expresses no opinion on the merits of that case, but its existence provides a realistic caution about the risks to customers inherent in AT&T's position on issue 24. Assuming AT&T could be trusted to properly "self-certify," under the FCC's interpretation of section 252(I), GTE would be required to allow all other CLECs to do so also. As a matter of public policy, the arbitrator should be reluctant to encourage such wide-scale "self-certification."

The Telecommunications Act of 1996, 104th Cong. 2d Sess., Report 104-458, Joint Explanatory Statement of the Committee of Conference ("Joint Explanatory Statement"), p. 86 (emphasis added).

While Section 222(c) is clear, AT&T may argue that its "self-certification" proposal is permissible under an exception to the written authorization requirement in Section 222(d)(1). Section 222(d)(1) does not prohibit a telecommunications carrier

> from using, disclosing, or permitting access to customer proprietary network information obtained from its customers, ...--to initiate, render, bill, or collect for telecommunications services.

AT&T appears to read this exception to mean that one telecommunications carrier (GTE) may disclose the CPNI of *its* customers in order to permit some *other* telecommunications carrier (AT&T) to initiate service. Quite apart from being an utterly stilted reading of an otherwise clear provision, AT&T's assertion is belied by the legislative history. In enacting section 222, Congress made clear that the purpose of subsection (d)'s exceptions is to protect the rights or property of the carrier providing service. Joint Explanatory Statement, p. 86. Nowhere did Congress ever suggest that the CPNI held by one carrier could be compromised solely for the benefit of some other carrier.

The FCC is currently undertaking a rulemaking to determine the appropriate processes for protecting CPNI when a customer changes local service providers. CC Docket No. 96-115. The parameters of the exception to

the written authorization requirement set forth in Section 222(d)(1) will be determined in that proceeding. GTE understands the FCC intends to issue an order in that proceeding by the end of 1996 (and likely before the Arbitrator acts on the arbitrated agreement in this proceeding). Consequently, it is GTE's intention to comply with whatever procedures the FCC establishes in a final and effective order with respect to release of CPNI to CLECs requesting service.

Issue #25 - Should GTE be required to perform loop testing on every new line under AT&T's standard of acceptance, and provide reports of test results to AT&T?

GTE Contract Provision - Article VI 4.4.1, 4.4.4.

GTE's Position - No.

Discussion - GTE does perform simple and complex testing of every loop. For complex "designed services" (i.e., services other than basic voice grade service), GTE agrees to perform loop testing to design specifications and to report test results. GTE, however, does not routinely test every simple non-designed new loop for itself, and therefore should not be required to meet another carrier's demands to do so for them. Certainly it should not be required to do so without compensation.

Issue #44 -How should the cost of access to OSS be recovered?

GTE Contract Provision - Article VIII 7; Appendix G 3.

GTE's Position - New development costs should be paid or secured by the cost

causer up front.

Discussion - GTE is entitled to recover all of its costs resulting from the design, testing, deployment, implementation and on-going support of gateway access. AT&T attempts to avoid responsibility totally. (AT&T 8.29) However, since AT&T is requesting access to OSS as an unbundled element, under section 252(d)(1) AT&T and other CLECS making similar demands must pay GTE's costs for providing the services.

It is not important, at this point, to know what the exact costs will be. It is critical, however, to determine how they will be recovered. GTE cannot be expected to rush to implement all of AT&T's demands upon only the vague assurance that it will pay its "fair share." AT&T witness Finnigan's attempted deprecations notwithstanding,[1/] GTE has shown its good faith by initiating deployment of interim access measures (including some electronic gateways) with no agreement on payment. (Cox Tr. 192, 195-96, 207) The lack of a clear directive for the CLECs to pay the costs of deploying both interim and long-term measures, however, is a recipe for delay and dispute on their part. Without this requirement, AT&T will have no incentive to ever come to agreement with GTE on cost recovery. And without being ordered to pay for the interfaces it

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[39/] Mr. Finnigan's exaggerated and inaccurate generalizations are typified by his reference to GTE's July 8, 1996 letter. In that letter GTE expressed understandable reluctance to commit to multi-million dollar system development projects when AT&T was at the same time declining to commit to "cost recovery methods" and demanding wholesale discounts ranging from fifty to eighty-five percent. (Page 2 of that letter was missing from the material served by AT&T on GTE in Washington and Oregon. GTE trusts it is present in the arbitrator's copy.)

demands, AT&T is not likely to seriously analyze the specific kind and degree of access it really needs, as opposed to just demanding interactive access to every system, even those that may be of little value.

GTE will derive no benefit from establishing gateways to allow third-party access to its systems, and AT&T has not been able to convincingly argue otherwise. Instead, AT&T offered the curious logic that AT&T should not have to pay GTE's costs simply because AT&T also has to develop its own half of the bridge. But AT&T has no right to make GTE pay for something GTE would not develop or use for its own operations. AT&T cannot point to anything in the Act suggesting that ILECs themselves must pay for third-parties' access to their OSS.

The arbitrator should order the CLECs--in this case, AT&T--to pay GTE all of its costs associated with the design, testing, deployment, implementation, and ongoing support for their requested access to GTE's OSS, including both interim and long-term measures. These payments to GTE would, of course, be in addition to any licensing fees AT&T might need to pay the third-party owner of GTE's OSS. The arbitrator should also recognize that GTE cannot produce firm cost estimates until after industry standards have been set and the carriers supply GTE with their access specifications.

Issue #45 - Should GTE be required to provide AT&T direct access to GTE's OSS systems through electronic interfaces?

GTE Contract Provision - Article VIII 7; Appendix G 3.

GTE's Position - No, not at this time.

Discussion - *Direct* access is not required, and should not be ordered. GTE agrees with AT&T that OSS functions should be accessed through a nationally standardized gateway. (AT&T 8.24). As discussed with regard to Issue #44, although national standards have not been set, GTE is actively working toward implementing a gateway that might not be based on such standards. It has targeted to complete this gateway by the end of March 1997. Once national standards are in place, GTE will modify its gateway if necessary and if requested by AT&T. It is GTE's understanding that AT&T has agreed to accept this interim solution.

Issue #46 - On what basis should OSS electronic interfaces be implemented?

GTE Contract Provision - Article VIII 7; Appendix G. 3.

GTE's Position - See GTE's position on Issue #45, above.

Issue #47 - Should AT&T have access to GTE's OSS processes through electronic interfaces for unbundled elements?

GTE Contract Provision - Article VIII 7; Appendix G. 3.

GTE's Position - See GTE’s position on Issue #45, above.

Issue #67 - Should GTE be required to provide billing and usage recording services for resold services, interconnection and unbundled elements, and if so, what terms and conditions should apply to such services?

GTE Contract Provision - Appendix G.

GTE's Position - There does not appear to be any material dispute on this issue. GTE agrees to provide usage recording services consistent with what it provides for itself.

Discussion - GTE will provide AT&T equivalent recording. If necessary, GTE will explore the possibility of enhancing its existing systems to provide additional services to AT&T, as long as AT&T commits to paying the associated costs (see Issue #68, below). (GTE 24.24-25).

Issue #68 - If GTE is required to provide the services identified in Issue #67, how should the costs of providing these services be recovered, and from whom?

GTE Contract Provision - No specific contract provision.

GTE's Position - System development and conversion costs should be recovered from AT&T via an up front payment. Operating costs should be recovered from AT&T on a usage charge basis.

Discussion - Neither the Act nor the FCC's Order requires GTE to absorb the cost of creating a billing system to provide AT&T with the requested billing. Any enhancement to GTE's billing system that may be required to meet or to satisfy AT&T's demand must be paid for by AT&T. Any such enhancement would inure

completely to the benefit of AT&T with no benefit to GTE at all. Of course, if other competitive local exchange carriers choose to use this same billing system, they too should share in the cost of the system and AT&T should be refunded by these other CLECs any amounts paid which may subsequently be shared by them. Development and system conversion costs should be covered up front by payment or secured payment commitment. Operating costs should be recovered by usage based charges.

SS7/AIN Issues

Issue #35 - Should GTE provide AT&T access to its AIN, and if so under what terms and conditions?

GTE Contract Provision -Article VI 12.

GTE's Position - GTE will allow AT&T to access GTE's AIN network and capabilities via GTE's Signaling Transfer Points (STPs) and Service Control Point (SCP). This issue is resolved.

Discussion - In its Order, the FCC interpreted the Act's unbundling provisions to require ILECS to make their AIN SCP (or database) available to competitors either through the sale of local switching services, or, if adequate safeguards exist, through interconnection of the competitor's local switch to the ILEC's STPs (Order ¶ 486).

AT&T's initial demand, in its Petition, for direct access to GTE's AIN "triggers," caused serious concern about significant negative impacts on the network and customers of GTE and other carriers. (GTE 18.11-17; GTE 16. 9-

14). At the time of the hearing, however, the parties reached agreement that AT&T will access GTE's AIN network and functions through GTE's STP and SCP. (GTE 29.1; Bohling Tr. 126-127, 130; Hall Tr. 127-128).

AT&T apparently continues to seek, however, the ability to control GTE's network from AT&T's AIN SCP - by definition a technically infeasible request, because it would significantly compromise the integrity of GTE's network. See the discussion of Issue #36, below.

Issue #36 - Should GTE be required to exchange AIN transaction capabilities application part message between GTE end offices and AT&T service control points via interconnection of AT&T's SS7 network to the GTE SS7 network?

GTE Contract Provision - Article VI 12.

GTE's Position - No. The requested interconnection would involve direct access to GTE AIN triggers and is not technically feasible.

Discussion - In defining "technically feasible," the FCC explicitly excluded access to network elements that would negatively affect network reliability and security:

> [L]egitimate threats to network reliability and security must be considered. . . . Negative network reliability effects are necessarily contrary to a finding of technical feasibility. Each carrier must be able to retain responsibility for the management, control, and performance of its own network.

(Order ¶ 203). Direct access to AIN triggers, as requested by AT&T, would threaten network reliability and security. As amply demonstrated by GTE's

testimony, end office switches were not designed to support the direct (i.e., unmediated) access AT&T seeks. For example, direct access could allow third parties to charge for: billing information; carrier identification codes; calling party numbers (which would impact on terminating services); and, privacy indicators. (GTE 18.9-13). AIN also introduces a set of functional capabilities that allow an AIN SCP to control internal switch call processing functions. Id. For all these reasons, direct access could severely impact the reliability and security of the public-switched network system, other telecommunications service providers' networks, and customer service. (GTE 29.2; Hall Tr. 128-141).

Issue #37 - Should GTE provide AT&T access to GTE's SS7 system, and if so, at what points and under what terms and conditions?

GTE Contract Provision - Article IV 9; Article VI 7; Appendix H.

GTE's Position - GTE will provide AT&T access to its SS7 system, but it is not technically feasible to unbundle the SS7 network into the discrete parts originally proposed by AT&T. This issue is resolved.

Discussion - Any attempt to fragment GTE's SS7 system and allow unbundled access to some components, as AT&T originally requested, would jeopardize network integrity, with potentially disastrous consequences. Further, there are no technical standards to support such unbundling.

Today, interconnection with an SS7 network occurs at the STP, which was designed to be the entry point to an SS7 network and to provide access to all

SS7 functions. The STP is the only physical point at which interconnection is technically feasible, and GTE will offer such interconnection. By interconnecting at the STP, AT&T can gain access to the SCPs and associated databases. AT&T can access all of the SS7 functions through this type of interconnection, and the unavailability of further levels of unbundling will not harm its ability to compete in the local service market.

AT&T has modified its request, and now seeks access to the service control points (SCP) and associated databases only through the STP pair associated with that SCP. (Bohling Tr. 142-144) Thus, the parties are in agreement on this issue, with the exception of rate design and billing capability issues.

AT&T's rate design request is not technically feasible, however, AT&T's proposed rate design for use of GTE's SS7 network includes usage rate elements not currently contained in GTE's relevant tariff and which GTE could not measure and bill. In order to modify its network and install this measurement and billing capability, GTE would have to make a significant new investment not warranted by AT&T's rate design preference. AT&T has not committed to covering such new costs. Moreover, AT&T could not rebut GTE's testimony on the technical infeasibility of creating a new billing capability. (Schwark Tr. 145-47, 149-51; GTE 30).

Issue #38 - Is GTE required to provide unbundled signaling elements (STP, SCPs, Links, etc.) at cost-based rates? Is GTE's SCP database an unbundled

network element as defined in the Act?

GTE Contract Provision - Article IV 9; Appendix H.

GTE's Position - As explained in response to issue 37, further unbundling the signaling elements is not technically feasible. (GTE 18.9-22). Access to the call related databases contained in GTE's SCP, via the associated STP pair, is defined by the FCC order as being an unbundled network element. GTE provides links and STP ports at rates contained in GTE's relevant federal tariff. These rates, approved by the FCC are cost-based.

Issue #69 - Should AT&T be charged for 800/888 database dips that result in that call being routed to GTE as the 800/888 service provider?

GTE Contract Provision - Article VI 9.

GTE's Position - Yes. The charge for database dips to GTE's 800/888 database is required to recover the appropriate costs which GTE indisputably incurs for database 800/888 functionality.

Discussion - The resolution of this issue is straightforward: AT&T must and should pay for use of GTE’s 800/888 database. GTE incurs significant network usage and attendant costs when AT&T uses its database. (Schwark Tr. 149-150). There is no legal requirement that GTE absorb these costs in order to benefit AT&T or any other carrier. Receiving revenue on an 800/888 call and receiving revenue for performing 800/888 database dips allow for the recovery of separate and distinct costs, and is, therefore, an appropriate resolution of this

issue. (GTE 7.5, 19; Perry Tr. 329, 333-34).

Collocation Issues

Issue #7 - What method should be used to price collocation?

GTE Contract Provision - Article IX 1.

GTE's Position - The collocation rates in GTE's federal collocation tariffs should be applied.

Discussion - GTE has a federal virtual collocation tariff which AT&T may use, and a new federal physical collocation tariff has been filed. (GTE 19.3). The rates in these tariffs have been set using a method that allows recovery of GTE's costs, including a reasonable share of its joint and common costs; are therefore fully consistent with the Act; and comport with the rationale and requirements of the FCC's *Expanded Interconnection Order*.

Issue #49 - When and in what circumstances should collocation be permitted?

GTE Contract Provision - Article IX.

GTE's Position - AT&T should be allowed to collocate at GTE central offices, including tandems, where space is available and it is otherwise technically feasible to do so. Collocation must be limited to transmission equipment. GTE must be allowed to use its own space within its engineering planning horizon. GTE agrees to provide connections between collocators; other connections are not allowed under the Act.

Discussion - Section 251(c)(6) of the Act requires incumbent local exchange carriers to allow competing telecommunication carriers to place equipment on their premises if necessary to interconnect with an ILEC's network or to access unbundled network elements being provided under the Act. AT&T takes the position that the Act permits it to have virtually unencumbered access to all of GTE's facilities to collocate whenever and whatever is to AT&T's convenience or advantage. The issue of particular types of equipment is discussed under Issue 50.

Under the Act, physical collocation is required unless space limitations call for the use of virtual collocation. Section 251(c)(6). Thus, while GTE supports virtual collocation, the arbitrator cannot mandate it in this case except where physical collocation is not possible; arrangements for virtual collocation in other circumstances is beyond the scope of this arbitration. (GTE 20.14-15)

In Washington, virtual collocation is available under GTE's federal tariff. There is no need for the arbitrated agreement to revisit those topics in order to provide AT&T a non-tariff option. As to physical collocation, the federal tariff which GTE has filed should be used. AT&T will have a full opportunity at the FCC to raise any legitimate concerns regarding price, terms and conditions. This approach should also be followed in order to enhance operational and administrative efficiencies for GTE and all collocating carriers. (GTE 19.3)

It is clear from the evidence that physical collocation will not be possible in certain GTE facilities, such as manholes and controlled environmental vaults ("CEV"), due to lack of space for the security structures needed for physical

collocation. It is also clear that manholes have insufficient space for even the virtual collocation of equipment, and that CEV's are also unlikely to have enough space for virtual collocation. (Peelman Tr. 72-73) Central offices and tandem sites, on the other hand, should be able to accommodate virtual collocation, and many such locations may have enough space for physical collocation by some number of other carriers. (GTE 20.11-14)

"Unused space" in the sense of space being available for the equipment of other carriers is properly based on GTE's service needs within its engineering planning horizons, as further discussed with regard to Issue 53.

The Act does not require that GTE permit collocators to connect with each other, but GTE is willing to facilitate such interconnections as discussed below with regard to Issue 51.

It is important to keep in mind that collocation is a limited measure, designed to remove technical barriers to new local exchange providers entering the local telephone market. Collocation is not intended as a vehicle by which new entrants may avoid offering true facilities-based competition by building their businesses on the premises of their competitors. If, as the Act intends, new entrants proceed rapidly to true facilities based competition, and a significant number of CLECs enter the market by using GTE's premises, available space will be rapidly exhausted. Thus, collocation is at best an interim measure. Like all interim measures under consideration in this case, its purpose must be twofold: to ease the initial process of building facilities, and to ensure that during this interim period customers are not disadvantaged. GTE's proposal fulfills both

of these objectives.

Issue #50 - What types of telecommunications equipment may be collocated on GTE's premises?

GTE Contract Provision - Article IX 1.

GTE's Position - AT&T should be permitted to collocate only that equipment that is necessary for interconnection or access to unbundled network elements. This includes transmission, concentration and multiplexing equipment, but does not include switching equipment, enhanced services equipment or customer premises equipment.

Discussion - Section 251(c)(6) of the Act requires incumbent LECs to provide physical or virtual collocation of equipment "necessary for interconnection or access to unbundled network elements." Thus, AT&T may collocate transmission equipment, concentration equipment and multiplexing equipment. Switching equipment, enhanced services equipment and customer premises equipment should not be allowed, as collocation for this equipment is not required under the Act.

The fundamental purpose of the "interconnection and access" provisions of the Act is to enable an interconnector to use ILEC network components without having to purchase complete switched access or exchange service. See Expanded Interconnection with Local Telephone Company Facilities, CC Docket

No. 91-141, and Amendment of Part 36, CC Docket No. 80-286, Second Report and Order and Third Notice of Proposed Rulemaking, 8 FCC Rcd. 7374, ¶ 62 (1993) (the "Switched Access Order") (a "'fundamental purpose of expanded interconnection . . . is to allow interconnectors to use LEC switches without having to purchase the LECs' end-to-end switched access services. If interconnectors want to do their own switching, they may place switches on their own property'") (quoting PacTel Comments at 46-47)), vacated insofar as it requires physical collocation, Bell Atlantic Tel. Cos. v. FCC, No. 93-1743 (D.C. Cir. Apr. 17, 1995), rules modified on remand, 9 FCC Rcd. 5154 (1994). The FCC has recognized the importance of limiting the types of equipment that must be collocated on a LEC's premises to equipment that is necessary and directly related to the competitive provision of basic transmission service. The FCC has consistently rejected suggestions that LECs be required to provide collocation of enhanced services equipment, customer premises equipment, switches, or other non-transmission equipment. See Special Access Order ¶ 63 ("LECs are not required to provide collocation of enhanced services, customer premises, or other non-transmission equipment."); In re Expanded Interconnection with Local Telephone Company Facilities, Memorandum Opinion and Order, 9 FCC Rcd. 5154, ¶ 94 (1994) ("Virtual Collocation Memorandum and Order") ("In our earlier orders, we required LECs to permit interconnectors to place . . . in LEC central offices only equipment needed to terminate basic transmission facilities . . . [w]e conclude that the same principles should apply [for the policies] we adopt in this order"). Congress was clearly aware of this history when it enacted section

251(c)(6).

Of primary concern to GTE is AT&T's request to collocate remote switching modules (RSMS") in GTE's central offices. GTE may at some time be interested in negotiating such arrangements as unregulated real estate transactions, but this topic is clearly outside of the Act and the scope of this arbitration. AT&T's initial focus on the small size of a particular RSM misses the point[1/], and its attempt to claim that RSM's are technically necessary in some circumstances for interconnection and access to unbundled network elements is transparently in error.

If the Act allowed the collocation of switching equipment, a fundamental problem would be that such devices typically occupy substantially more space than does the equipment necessary for interconnection or access to unbundled network elements. If AT&T were permitted to place switching equipment on GTE's premises, it would quickly exhaust existing space available for collocation, as well as for GTE's own uses of its property. For example, if the first party seeking collocation were allowed to install switches, inadequate space would be available for other competitors to collocate equipment essential to offering basic services. That first collocator, presumably AT&T, would be able to monopolize the limited amount of usable space in GTE's facilities and deny other interconnectors the opportunity to collocate on GTE's premises in order to

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[40/] Mr. Bohling confessed that AT&T does not, in fact, agree to use only the smallest RSM's if collocation of them is allowed. (Bohling Tr. 106-107)

compete directly with AT&T and GTE. Such a result would clearly be contrary to the purposes of the Act. AT&T's touting of the small size of a particular RSM (with which GTE disagrees based on information from the manufacturer and its experience with switch installations just misses the point. (Peelman Tr. 88, 101-102) The Act contains no exception for small switches.

AT&T claimed that "back-to-back IDLC" situations cause transmission degradation, and that the use of RSMs is necessary for interconnection in those cases. Such equipment configurations can create concerns about transmission, but the fatal flaw in AT&T's position is that use of an RSM will not solve the problem. Different solutions using equipment other than switches will solve the problem. (Peelman Tr. 73-75, 93). Therefore, under the Act, AT&T cannot demand to collocate RSMs. Moreover, AT&T's proposal would create serious capacity problems for GTE. (Peelman Tr. 40-41)

AT&T's real goals are plain - to enhance the efficiency of its network on GTE's back, while preparing to bypass GTE's services. (Bohling Tr. 107-109) The Act's narrow collocation provisions clearly does not authorize such commandeering of ILEC property.

Issue #51 - Should GTE be required to provide interconnection between carriers at cost-based rates when those carriers are both collocated at a GTE premises?

GTE Contract Provision - Article IX 1.3

GTE's Position - No, although GTE has agreed to do so.

Discussion - Here again, AT&T has requested something not covered or

allowed by the Act. The Act is very clear and specific that collocation is for the sole purpose of connecting with GTE's network. Section 251(c)(6). Congress has not required that GTE turn its central offices into multi-company network hubs, regardless of how convenient other carriers may find such an arrangement.[1/] Thus, arrangements for inter-collocator connections are outside the scope of this arbitration; GTE will negotiate them separately. GTE has already agreed to provide connections between collocators, but has not agreed to allow collocators to make direct connections between themselves. (GTE 20.15-17).

Even if the Act mandated such inter-collocator connections, the manner of such connections should be subject to security, space management and network integrity considerations. (GTE 20.15, 16-17). Having GTE make any inter-collocation connections removes the concerns which would arise from collocators themselves running cable across the central office and between cages. The FCC's Order allows collocating customers to connect directly to each other if the incumbent LEC elects not to provide this connection. Rule § 51.323(h)(1). Here, however, GTE has agreed to provide this connection through the purchase of a GTE unbundled network element. (GTE 20.6, 16-17)

[41/] Again, as noted above, AT&T's real goal is to build its network on GTE's property and then bypass GTE. (Bohling Tr. 107-109)

Issue #52 - What limits, if any, may GTE impose upon the use of the collocated space?

GTE Contract Provision - Article IX 1.

GTE's Position - In addition to the building type and equipment type restrictions previously discussed, AT&T must abide by reasonable security, space use and network integrity requirements.

Discussion - Collocation activities must also be conducted safely and in a manner which will not damage or degrade GTE’s network or other facilities. For example, proper bonding and electrical surge protection must be in place. Excessive use of electrical power and the use of hot running equipment which would strain environmental control systems cannot be permitted. GTE is confident that these details will be readily worked out between the parties with regard to each collocation. (GTE 20.15)

Issue #53 - Does GTE have the right to reserve central office space for its own use or deny access for lack of physical space reasons?

GTE Contract Provision - Article IX 1; Article IX 1.1.

GTE's Position - Yes. The Act, the FCC Order and sound public policy support GTE reasonably reserving portions of its own property for its own use. A general five year engineering and planning horizon is reasonable for this purpose.

Discussion - The Act does not evidence any intent by Congress to completely oust GTE from the enjoyment of the normal rights of property ownership. GTE

must retain the ability to use its property for its own legitimate purposes, including the meeting of its service obligations

In some older central offices which formally housed large electro-mechanical switches, GTE may have more space than it will need for future digital switching equipment additions. (In many cases the company has reused that extra space for administrative offices and other needs.) On the other hand, in many locations GTE's engineers anticipate the need to add equipment within the relatively near future; they know the likely size of that equipment, its power and environmental requirements, and so on; and the company counts on (i.e., "reserves") having existing space available for those uses. This space should not be taken away from GTE and handed over to competitors; it should not be considered space available for collocation under the Act. The FCC has correctly recognized that ILECs will need to reserve space for future expansion, and that collocators can, on a first-come-first-served basis, rent more space than required for their immediate needs (subject to reasonable anti-"warehousing" rules). First Report and Order, e.g., ¶ 586. This is reasonable because GTE on the one hand and AT&T on the other will bear the cost of the space they are "reserving" for future use. AT&T's demand that GTE forego reserving any space in order to hold space available for AT&T's possible future use would be a clear subsidy from GTE to AT&T. This result should not and cannot be ordered.

GTE believes that a 5-year planning horizon for reservation of space is just and reasonable. This is especially true given GTE's obligation under state law to serve all customers who request service, that GTE has substantially

greater equipment needs (and obligations) than do CLECs, and that GTE must plan not only for its future expansion but also for collocation demands by an unknown number of CLECs.

Issue #54 - Is GTE required to make additional space/capacity available to AT&T for collocation if GTE does not have current space available? If so, in what time frame should GTE make such capacity available?

GTE Contract Provision - Article IX 1.1.

GTE's Position - No. The Act does not require ILECs to build more space for the benefit of collocators.

Discussion - Under § 251(c)(6), ILECs must provide for collocation "at the premises of the local exchange carrier." The word "premises" refers to an incumbent LEC's existing space, not the space (or premises) that an ILEC could or might acquire for its own benefit or for the benefit of a third party. Given this clear and unambiguous statutory language, GTE should not be required to procure or make available additional space where GTE's existing space is insufficient to accommodate a collocation request. Further, the FCC's Rule § 51.323(f) currently provides that GTE may not "be required to lease or construct additional space to provide for physical collocation when existing space has been exhausted."

Ancillary Services

Issue #22 - Should GTE make secondary distributions of directories to AT&T's customers without charge?

GTE Contract Provision - Article VII 7.4

GTE's Position - No. GTE is entitled to compensation from AT&T for every service and product it provides.

Discussion - Secondary distribution refers to the distribution of directories to customers who initiate service following the annual distribution of directories or who request additional copies of the directories. GTE is currently charged for secondary distribution. GTE seeks only to charge AT&T for such secondary distribution at the same rate GTE is charged. AT&T, however, by asking the arbitrator to find that it should not pay for secondary distribution, is in essence asking for a superior financial arrangement than GTE receives for its own customers. The arbitrator should reject AT&T's attempt to gain an unfair financial advantage, and should find that GTE may charge AT&T for secondary distribution of directories at the same rate that GTE itself is charged.

Issue #29 - Should GTE be compelled to provide the same number of directory pages to AT&T as GTE has for its own use for branded service information?

GTE Contract Provision - Article VII 7.6

GTE's Position - No. The Act does not require GTE to make any directory pages available to AT&T, and such compulsion would violate the First

Amendment.

Discussion -This is another AT&T request which is outside the scope of the plain meaning of the Act. Thus, while GTE is willing to provide the service, it cannot be mandated by the arbitrator in this case.

AT&T cites section 251(c)(4)(B) of the Act, which pertains to the resale of GTE's retail telecommunications services. Directory information page listings are not mentioned anywhere in that section, and such a listing is certainly not a telecommunications service within the meaning of the Act. As discussed above, when AT&T buys a GTE retail telecommunications service for resale, it takes that service as it is described and provided to retail customers under GTE's tariff. GTE's retail telecommunications services do not include directory information page (as opposed to white and yellow page) listings.

AT&T also cites section 251(b)(3), which concerns "dialing parity." Clearly, as defined by the Act, dialing parity involves only network dialing and routing arrangements, not directory listings.

Moreover, GTE has a First Amendment right to control the content of its publications, including the covers and pages of its directories. GTE cannot be compelled to alter its directories--and thus its speech--to conform to an agenda (e.g., the marketing of a competitor's products and services) which GTE has not set. See, e.g., Pacific Gas & Elec. Co. v. Pub. Util. Comm'n of California, 475 U.S. 1, 9 (1975); Central Illinois Light Co. v. Citizens Util. Board, 827 F.2d 1169, 1172-73 (7th Cir. 1987). Under the First Amendment, GTE has the right to control the content of its own publication, a right that also includes the right to

decide what not to say. Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston, 115 S. Ct. 2338 (1995).

GTE, however, has agreed to provide AT&T at this time with one directory information page, and has offered a 35% discount on the usual directory purchasing rate.

Contract Issues

The specific open issues were enumerated by the parties in their joint matrix. The fact that the parties have submitted proposed interconnection agreements, however, does not mean that all terms and conditions covered in either draft are submitted for arbitration. Miscellaneous issues of a contract wording nature are as follows.

Issue #5 - Should bill-and-keep be used as a reciprocal compensation arrangement for transport and termination of local traffic on a temporary or permanent basis?

GTE Contract Provision - Article IV 3.3; Appendix C.

GTE's Position - No. Unlimited bill and keep cannot and should not be imposed. GTE's proposal for bill and keep as to traffic flows which are roughly in balance should be adopted. See the discussion of Issue 4.

Discussion - The Act does not require the parties to use bill and keep as a method for reciprocal compensation. (47 U.S.C. § 252(d)(2)(b)). Under the Act, any compensation mechanism for transport and termination of traffic must

"provide for the mutual and reciprocal recovery by each carrier of costs associated with the transport and termination on each carrier's network facilities of calls that originate on the network facilities of the other carrier." The cost determination must be made "on the basis of a reasonable approximation of the additional costs of terminating such calls." (47 USC § 252(d)(2)(A)(ii)).

As discussed with regard to Issue 4, these costs for GTE should be determined using the market-efficient component pricing rule. In no event should the arbitrator accept AT&T's TELRIC calculations, which grossly underestimate GTE's costs.

GTE has shown that a symmetrical pricing approach will also result in under recovery of GTE's costs. AT&T's call termination costs will most likely be less than GTE's due to the expectation that AT&T will deploy newer equipment using a relatively higher percentage of its network's capacity. Under symmetrical pricing, GTE will thus subsidize AT&T, because AT&T will receive more than it costs AT&T to complete a call. This outcome is impermissible under the Act.

The arbitrator should also refuse to mandate a bill-and-keep arrangement. There is no way for this arbitrator to determine whether the volume of traffic exchanged will be equal, such that bill-and-keep would produce adequate cost recovery. A bill-and-keep mandate would thus lack the requisite evidentiary foundation.

Nevertheless, GTE is willing to voluntarily agree to bill and keep as long as the proposed arrangement, predicated upon approximately equal traffic flows, would be for transport and termination of <u>local</u> traffic only. Also, interLATA

access must be carried over separate trunk groups and not intermingled with local and local toll traffic. In the spirit of promoting the competitive process, GTE proposes a broad definition of roughly balanced as equating to plus or minus ten percent. The originating/terminating split could thus be up to 60/40. (GTE 7.24-25, 14.21-22)

Issue #12 - What is a reasonable period for advance notification of new services?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - GTE will notify AT&T of new retail telecommunications services at the time GTE files its tariffs for such services.

Discussion - AT&T requests special treatment with regard to retail telecommunications services it wishes to resell. The Act does not require such special treatment, and, in any event, normal notice periods will be adequate for AT&T's purposes.

When GTE or any other ILEC offers a new service, it makes a tariff (or price list) filing. The statutory time period between filing of a tariff and its effective date has worked in Washington for many years and there is no reason to change it. GTE itself often does not know final details of service changes or new service introductions much more than a day or two before the tariff is filed. This just-in-time tariff process is consistent with the demands of a competitive marketplace. Service development cycles are constantly being compressed, and

details regarding ordering, billing, feature availability, and prices are finalized literally days or hours before a filing. These tariffs provide public notice of all new services, and competitive local exchange carriers have access to such tariff filings, just as the general public does. Thus, GTE's tariffs will themselves serve as notification for new services.

AT&T's proposal for a 45-day advance notification period is severely out of step with these practical considerations. It would be impossible for GTE to comply with this demand -- or with any uniform, mandatory notice period -- without crippling GTE's ability to quickly respond to its competition. If a specific notice period is imposed, it is inevitable in some instances that GTE will have to either delay introduction of a service or risk violating the notice rule. This is not the way to create fair and effective competition.

AT&T cites FCC Rule 51.603 in support of its request. AT&T's request for a 45 day advance notification period is commercially unreasonable, and Rule 51.603 is inapposite. This rule sets forth the general resale obligations if incumbent LECs, and states that a LEC must provide services to requesting carriers within certain provisioning time intervals -- it does not speak to the notification of new services. Moreover, the decision of whether and when to make a new service offering is fact-dependent, and a "one size fits all" approach to notifications will not work in a changing business environment.

Issue #59 - What should the term of the agreement be?

GTE Contract Provision - Article III 2.

GTE's Position - Two years.

Discussion - Flexibility combined with short-term stability is what the parties in this market need. The telecommunications marketplace is in the throes of stunning change. Technology continues to evolve at a record pace. The legal regime governing the industry has been completely overhauled. Firms are combining and recombining in ways that defy traditional lines of interest.

It is anyone's guess as to what market contours this chaos will eventually produce. Long-term agreements between firms operating in the shifting environment are more likely to undermine competition than promote it, given the extreme uncertainty surrounding the advent of local competition.

A two year term is appropriate. AT&T's proposed five-year term is far longer than the period needed to transition from monopoly to competition. Even though AT&T argues for a five-year term, it proposes to hedge its bets with a provision giving it the unilateral ability to terminate its contract with GTE on 90 days' notice. This unreasonable proposal (which amounts to elimination of any term provision at all) illustrates AT&T's apparent attitude that it should be permitted to saddle GTE with all the risks and uncertainties of AT&T's doing business. AT&T attempts to rationalize its five-year proposal with analogies to the interexchange market twenty years ago. This argument, of course, asks the Arbitrator to ignore the enormous differences between AT&T today -- a giant corporation with the ability to leverage the biggest share of the interexchange market -- and AT&T's nascent long-distance challengers two decades ago.

AT&T's five-year proposal, if adopted, would prevent efficient readjustment of relationships between market participants that otherwise would be inevitable as competition progresses and the effectiveness of the initial ground rules is tested. A two-year term, on the other hand, properly balances the interests of all competitors, GTE included. It is long enough to establish open and effective market entry by AT&T, particularly considering its sophistication and financial wherewithal, and to permit all parties to plan their business activities. At the same time, it promises a foreseeable window of renegotiation and readjustment, and it avoids the risk of imposing long-term and irreversible disabilities on GTE.

Issue #60 - Should the agreement be implemented without impairing GTE's right to file tariffs in the normal course of business?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - Yes. No provision of the Act prevents GTE from filing tariffs. The issue is the relation between tariffs and the agreement.

Discussion -Obviously the agreement cannot prevent or prohibit GTE from continuing to file tariffs, and AT&T does not appear to be seeking that literal result. GTE must have the ability to file tariffs to modify its retail services subject to resale. Otherwise, GTE could not keep pace with customer demand, an outcome that would harm both GTE and resellers taking its wholesale services. Rather, AT&T wants to obtain unilateral flexibility to select options most favorable to it and least favorable to GTE.

GTE agrees that changes to its retail tariffs will automatically apply to AT&T in its capacity as a reseller of those services. Changes to access services and other offerings outside of the scope of the agreement will also apply to AT&T. With regard to new unbundled network elements and other offerings uniquely treated in the agreement, however, AT&T needs to make a choice. GTE and its other contract customers face this issue on a regular basis and make a bargain based on several factors. Most notably, the parties determine for themselves the value of stability versus the chance that new tariff filings will have higher or lower prices.

Particularly given the level of uncertainty accompanying the initiation of local competition, GTE does not believe the arbitrator should constrain the Commission's jurisdiction by a blanket declaration that tariffs can never affect the contracts that result from this arbitration. With regard to initial pricing decisions, the arbitrator may include a condition in the agreement that adopts GTE rates as interim prices, subject to resetting and true-up in a follow on proceeding under the Act. Beyond that, the agreement should allow the Commission to determine on a case by case basis whether a change in the agreement should be made due to a tariff filing, based upon all considerations pertinent at the time, including the public interest and market factors.

Issue #61 - Should the agreement provide for an accelerated dispute resolution procedure in case of "service affecting" disputes?

GTE Contract Provision - Article III 12.4.

GTE's Position - No additional provisions are needed.

Discussion - Insofar as resold and other tariffed services are concerned, AT&T has available to it normal company and Commission dispute resolution procedures. In addition, GTE's contract dispute resolution provisions adequately protect the interests of the parties in obtaining prompt resolution of problems, while avoiding costly and time consuming litigation. AT&T submitted revised provisions -- almost triple the length of AT&T's original proposal -- on September 29, which contain complicated unnecessary provisions that run contrary to the objectives of the entire dispute resolution process.

Issue #62 - Should the agreement provide for a "Most Favored Nations" clause?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - No.

Discussion - This issue is similar to Issue 60, but involves AT&T's desire to pick and choose provisions from other agreements negotiated or arbitrated under the Act. The United States Court of Appeals for the Eighth Circuit has ordered that the "most favored nations" provision embodied in the FCC's First Report and Order be stayed. In so doing, the Court noted:

> The petitioners' objection is that the rule would permit the carriers seeking entry into a local market to "pick and choose" the lowest-priced individual elements and services they need from among all of the prior approved agreements between the LEC and other carriers, taking one element and its price from one agreement and

> another element and its price from a different approved agreement. Moreover, if an LEC and Carrier A, for example, reach an approved agreement, and then the LEC and a subsequent entrant, Carrier B, agree in their agreement to a lower price for one of the elements or service provided for in the LEC's agreement with Carrier A, Carrier A will be able to demand that its agreement be modified to reflect the lower cost negotiated in the agreement with Carrier B. Consequently, the petitioners assert that the congressional preference for negotiated agreement would be undermined because an agreement would never be finally binding, and the whole methodology for negotiated and arbitrated agreements would be thereby destabilized.
>
> * * *
>
> We are persuaded . . . by the petitioners' evidence that the negotiations preferred by the Congress are already breaking down . . . . These experiences indicate the FCC's pricing rules will derail current efforts to negotiate and arbitrate agreements under the Act, <u>and the "pick and choose" rule will operate to further undercut any agreement that are actually negotiated or arbitrated. The inability of the incumbent LECs and the state commissions to effectively negotiate and arbitrate agreements free from the influence of the FCC's pricing rules, including the "pick and choose" rule, will irreparably injure the interests of the petitioners</u>. (emphasis added).

The arbitrator likewise should decline to adopt AT&T's pick and choose concept. One of the principal purposes of the Act is to encourage parties to <u>negotiate</u> interconnection agreements. Indeed, parties may seek arbitration only where their negotiations fail. <u>See</u> 47 U.S.C. § 252. If the agreement included a Most Favored Nations (MFN) clause, then the parties would have little to no incentive to negotiate, thereby frustrating on of the principal purposes of the Act.

Typically, contract negotiations involve one party "giving in" on one issue in return for "winning" another, perhaps wholly unrelated issue. The end result,

however, is satisfactory to both parties. An MFN clause, however, would negate this contracting process for pending and future negotiations; GTE would have no incentive to "give" on one issue even if GTE "wins" on another issue, because another CLEC would seek the favorable provision but refuse to accept the other.

Issue #63 - Should the agreement provide for a Bona Fide Request Process?

GTE Contract Provision - Article VI 4.8.1

GTE's Position - Yes, although GTE does not agree with AT&T's proposed language.

Discussion - GTE agrees that the parties should maintain flexibility to address changed circumstances and new developments. In fact, a number of the specific contract provisions which AT&T proposes for longer term needs should be deleted from the agreement and handled under a bona fide request process. Attempting to at this time set contract language for every eventuality obviously involves speculation, and the parties are unlikely to arrive at the correct approach and verbiage.

Issue #64 - Should GTE be required to accept financial responsibility for uncollectible and/or unbillable revenues resulting from GTE work errors, software alterations, or unauthorized attachments to local loop facilities?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - No.

Discussion - GTE's current tariff provisions giving credit for service interruptions

should continue to govern its relations with other carriers. As to resold services, the tariff provisions automatically apply; they should not and cannot be changed by the arbitrator. As to unbundled network elements, the comparable provisions of GTE's access tariffs should be incorporated in the agreement. (GTE 1.13-14)

The arbitrator must reject AT&T's proposed indemnification provisions because the unknowable costs of unlimited consequential damages have not and cannot be factored into the rates charged to AT&T. AT&T seeks, in essence, to impose a strict liability standard upon GTE. Such a standard is commercially unreasonable. For example, AT&T wants GTE to agree to become liable for unauthorized attachments to local loop facilities, while at the same time AT&T is requesting access to the local loop and to sub-loop elements. Given that incumbent LECs' networks will be "opened up," at least in part, to many new carriers, it is unreasonable to impose a strict liability standard upon GTE.

This issue and AT&T's position only compounds the problems that arise under AT&T's view on the quality of service GTE should be required to provide. As already discussed above, AT&T wishes to have GTE give it special consideration, altering the quality of service required by the Commission. At the same time that AT&T wishes to have a flexible and increasing quality standard, it also wishes to hold GTE liable for any failure to achieve that higher standard. GTE should not be required to meet quality standards (e.g., outage times) that are different from or greater than those established by a commission for GTE or those adhered to by GTE in its regular course of business - especially without the compensation reflecting these higher standards and attendant contract risks.

Accordingly, GTE should not be required to indemnify AT&T for any and all losses purportedly associated with the features or services GTE provides.

GTE's current tariffs grant customers pro-rata credit for service outages and interruptions. These longstanding provisions govern GTE's relationships with end user, as well as carrier, customers. AT&T has taken access services from GTE under these provisions for well over ten years without raising any concerns about indemnification if GTE's network fails to function as intended. There is nothing in the Act that requires -- either implicitly or explicitly -- any revisions to GTE's limitations of liability. Indeed, the proposals advanced by AT&T are impermissible under the Act and inconsistent with its goal of encouraging efficient competition.

The fundamental problem is that there are no limits to the liability that GTE could incur, because any "action or inaction," intentional or unintentional, would require payment from GTE. In every case, AT&T could--and, acting as a self-interested business, would--claim that GTE either caused or could have prevented AT&T's purported revenue losses. Occurrences giving rise to liability could range from the mundane missed due date to the more unusual software glitch that cripples the network. In the latter case, as AT&T well knows from its own experience, uncollectible or unbillable revenues could be substantial.

Moreover, AT&T will have limitation of liability provisions with its end use customers. Collecting penalties or damages from GTE without having a corresponding liability to its own customers would simply create a windfall for AT&T.

Issue #65 -To the extent not otherwise specifically resolved herein, what terms and conditions should be included in the agreement adopted in this arbitration proceeding?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - GTE has submitted an agreement which complies with the Telecommunications Act of 1996 and Washington state law, and is a reasonable and workable commercial agreement. As discussed previously, the arbitrator should not try to, in effect, draft a detailed contract. Indeed, AT&T acknowledged numerous times that many issues and particulars still need to be negotiated by the parties. (E.g., Menezes Tr. 211; Bohling Tr. 123)

Issue #66 - Should the agreement impose material and reciprocal obligations upon both parties with respect to matters other than reciprocal compensation arrangements for transport and termination?

GTE Contract Provision - No specific contract provision exists.

GTE's Position - Yes. Reciprocal arrangements will promote equity as well as competition. AT&T should have the same obligations as GTE under the parties' contract.

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Respectfully Submitted,

GTE NORTHWEST INCORPORATED

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