LAW OFFICES

GULLETT, SANFORD, ROBINSON & MARTIN, PLLC

230 Fourth Avenue, North, 3rd Floor
Post Office Box 198888
Nashville, Tennessee 37219-8888

Telephone (615) 244-4994
Facsimile (615) 256-6339

GARETH S. ADEN
G. RHEA BUCY
GEORGE V. CRAWFORD, JR.
A. SCOTT DERRICK
BETH EDMONDSON
THOMAS H. FORRESTER
M. TAYLOR HARRIS, JR.
LINDA W. KNIGHT
JOEL M. LEEMAN
ALLEN D. LENTZ
JOSEPH MARTIN, JR.
JUSTIN T. MILAM
JEFFREY MOBLEY
[illegible] C. MURPHY

KATHRYN H. PENNINGTON
WM. ROBERT POPE, JR.
WAYNE L. ROBBINS, JR.
JACK W. ROBINSON, JR.
JACK W. ROBINSON, SR.
VALERIUS SANFORD
WESLEY D. TURNER
JOHN KNOX WALKUP
ANNE D. WATERS

[illegible] D. LENTZ
OF COUNSEL

B. B. GULLETT
1905-1992

OFFICIAL FILE
PLEASE
DO NOT REMOVE

REC'D TN
REG. AUTH.
'97 FEB 14 AM 11 40
OFFICE OF THE
EXECUTIVE SECRETARY

February 14, 1997

David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37201

Re: Tariff Filing by UTSE to Reflect Annual Price Cap Adjustment, Tariff No. 96-201
Docket No. 96-01423

Dear Mr. Waddell:

Enclosed for filing in the above-styled matter are an original and thirteen (13) copies of the testimony of G. Michael Harper on behalf of AT&T Communications of the South Central States, Inc.

Copies are being served on counsel for parties of record.

Yours very truly,

Val Sanford

Val Sanford

VS/ka
Enclosures

cc: Guy M. Hicks, Esq.
L. Vincent Williams, Esq.
Richard M. Tettelbaum, Esq.
James B. Wright, Esq.
James P. Lamoureux, Esq.

DIRECT TESTIMONY OF

G. MICHAEL HARPER

ON BEHALF OF AT&T COMMUNICATIONS

OF THE SOUTH CENTRAL STATES, INC.

BEFORE THE

TENNESSEE REGULATORY AUTHORITY

Docket No. 96-01423

Filed: February 14, 1997

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION WITH AT&T.

A. My name is G. Michael Harper and my business address is 1200 Peachtree Street, Atlanta, Georgia. I am employed by AT&T as Manager—Network Services Division organization.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES WITH AT&T?

A. I am responsible for managing AT&T's regulatory initiatives and participation in proceedings affecting the prices for interconnection, unbundled network elements and access charges paid by AT&T in Alabama, Kentucky, Louisiana, Mississippi and Tennessee, as well as other related issues.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I have a Bachelors Degree in Physics and a Master of Business Administration from the University of Louisville in Louisville, Kentucky.

I have over thirty years of experience in telecommunications. I was employed by South Central Bell in Louisville, Kentucky and Birmingham, Alabama until December, 1983, holding positions in outside plant engineering, investment and costs engineering, and Bell-Independent Relations, among others. My responsibilities at AT&T have included Local Exchange Company relations and regulatory docket management. I assumed my current responsibilities in January, 1993.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to:

1. Demonstrate why United Telephone-Southeast's ("United") intrastate switched access charges should be priced at Total Element Long Run Incremental Cost (TELRIC) in concert with the recommendations contained in the FCC's Local Competition Order issued August 8, 1996.

2. Demonstrate that United's intrastate switched access charges are excessive and retard the development of telecommunications competition in Tennessee.

3. Provide specific recommendations for United's switched access charges in light of United's recent access rate changes that have the net effect of an <u>increase</u> in access charges to AT&T and the other IXCs. Such increases in access are contrary to the movement in the industry today to cost-based rates for network capabilities that will be required by potential competitors, including switched access services.

4. Show how United's intrastate, intra-market toll rates, in conjunction with their intrastate access charges, deter the entrance of competition for intra-market toll services in Tennessee.

Q. WOULD YOU PLEASE EXPLAIN THE TERM TOTAL ELEMENT LONG-RUN INCREMENTAL COSTS (TELRIC)?

A. Yes. The concept of "Total Element Long-Run Incremental Cost" (TELRIC) is described in the FCC's Order of August 8, 1996. The competition rules contained in the Order define TELRIC as the forward-looking cost over the long run of the total quantity of facilities and functions directly attributable or reasonably identifiable as incremental to a specific element. This calculation assumes the incumbent local exchange carrier's provision of other elements. In addition, TELRIC reflects the use of the most efficient telecommunications technology currently available, the lowest cost network configuration based on the existing location of incumbent wire centers, forward-looking cost of capital, and economic depreciation rates.

Q. DO THE FCC REGULATIONS PRECLUDE CERTAIN PRICING ACTIONS?

A. Yes. The FCC regulations state that embedded costs, retail costs, opportunity costs and services subsidies shall not be considered in the calculation of forward-looking economic cost.

Q. WHY SHOULD UNITED'S INTRASTATE SWITCHED ACCESS CHARGES BE PRICED AT TOTAL ELEMENT LONG RUN INCREMENTAL COST (TELRIC)?

A. First, the Telecommunications Act of 1996 requires incumbent local exchange companies to make certain network capabilities available to alternative carriers and to price those capabilities in accordance with specific rules. While the Act considers network capabilities in connection with unbundled network elements, switched access services use the same individual network elements and should, thus, be priced in the same cost-based manner. For example, the local loop, end office switching, tandem switching, and common and dedicated transport facilities are used for the provision of both interstate and intrastate switched access charges as well as for unbundled network elements that will be utilized by alternative local exchange companies (ALECs) in the future. The cost to United to provide these network capabilities is the same, regardless of how the elements are used.

Second, switched access service is a vital input necessary for alternative carriers to offer competing services and is essentially available only from incumbent local exchange carriers. It is, therefore, critical to the development of competition in Tennessee that switched access charges be priced at cost-based, TELRIC rates just as the unbundled network elements are.

Q. THE FCC ORDER DEALING WITH LOCAL COMPETITION ISSUES HAS BEEN STAYED AS TO CERTAIN PRICING PROVISIONS. WHAT SIGNIFICANCE DOES THE STAY HAVE TO THE TENNESSEE REGULATORY AUTHORITY (TRA) RELATIVE TO PRICING CONSIDERATIONS IN THIS CASE?

A. It is my understanding that the stay was a result of a jurisdictional dispute. The FCC Order incorporates sound pricing policy and makes good economic sense. The TRA is free to adopt the same sound policies in decisions it makes in this proceeding, as it decided it was free to do in the AT&T/MCI/BellSouth Arbitration.

Q. WHAT ARE THE SPECIFIC REQUIREMENTS OF THE FCC'S RULES REGARDING PROVISION OF NETWORK CAPABILITIES?

A. The Telecommunications Act of 1996 requires local exchange companies to provide capabilities to new entrants in the local services market to facilitate the development of local competition. The FCC's August 8, 1996 Order [61 Fed. Reg. 45,476, et.seq. (1996)] establishes regulations that specify the manner in which the local exchange carriers must provide these capabilities. The local companies are permitted to recover their economic costs to the extent that such charges conform to specific provisions of the Act and the FCC regulations.

In addition, the FCC regulations require that the incumbent local exchange carrier prove to the state commissions that the rates offered for each element do not exceed the element's forwarding-looking economic cost per unit. The rules define such cost as equal to the forward-looking economic cost of the element, divided by the sum of (1) the total number of units of the element that the incumbent local exchange carrier will likely provide to requesting carriers and (2) the total number of units that the incumbent local exchange carrier will use in offering its own services. The FCC regulations define forward-looking economic cost as the total element long-run incremental cost of the element (TELRIC) plus a reasonable allocation of what the FCC refers to as forward-looking "common" costs.

Q. WHY DO YOU BELIEVE THAT UNITED'S INTRASTATE SWITCHED ACCESS CHARGES ARE EXCESSIVE AND RETARD THE DEVELOPMENT OF TELECOMMUNICATIONS COMPETITION IN TENNESSEE?

A. There is an abundant record, both in Tennessee, and in other jurisdictions nationwide, that the actual cost that local exchange companies incur to provide switched access services is well below one cent per minute for both ends of switched access service. In general, local exchange companies charge interexchange carriers far in excess of this amount. Exhibit GMH-1 to this testimony compares the current intrastate access rates that United charges interexchange carriers today in Tennessee with the estimated cost that United incurs to provide the service.

Q. WHY ARE UNITED'S ACCESS CHARGE RATES IN TENNESSEE PRICED SO FAR IN EXCESS OF THE COST TO PROVIDE THE SERVICE?

A. Local exchange companies, both in Tennessee and across the country, have traditionally priced access far in excess of its cost in order to provide a subsidy to local exchange service. The retail price of local exchange service has been artificially low in order to support policy goals of affordable local service and availability of telephone service to all consumers of the state.

In recent years, however, there are more frequent indications that (1) the cost of providing local service has been declining, and (2) in certain jurisdictions the price of local service is already covering its costs. It is clear that the total amount that has been traditionally asserted to be needed by the local exchange companies to support local service is not as large as believed and is declining over time.

Just as significant, however, is the method by which such artificial support of local service costs have traditionally been achieved. First, the perceived subsidy requirement has been associated with all consumers regardless of need. In other words, a telephone subscriber with a household income of $2,000,000 receives the same subsidized support of its local service rate as a household with an income of $20,000. Second, the support collected for the subsidy has been collected primarily from interexchange carriers in the form of switched access charges. Certainly, local exchange companies have sources of support from other high-margin services, vertical features like call waiting and call forwarding for example, but nothing as significant as the magnitude of switched access charge revenues, both in terms of the current amounts collected and the percentage growth that access charges are experiencing.

Q. WHAT ARE SOME OF THE EFFECTS OF CHARGING INTEREXCHANGE CARRIERS ACCESS RATES THAT ARE FAR IN EXCESS OF COSTS?

A. First, interexchange carriers must pass these rates on to consumers resulting in intrastate toll rates that are far in excess of toll rates that would exist if access charges were priced at more cost-based levels. Such subsidy transfers could be reasonably rationalized during the time when all providers participated in the Bell Division of Revenues process and were compensated for both local and toll expenses on an equitable basis. Today and in the future, however, it is no longer equitable to expect interexchange carriers and other competitors of the local exchange companies, to subsidize the local exchange company for uneconomic arrangements and for expenses that have largely not been produced for examination and validated.

Second, to the extent the local exchange carriers do <u>not</u> require all of the subsidy generated by access rates at the current level, the local carriers are free to use these excess profits for any purpose that they desire. For example, many local exchange companies, including United in Tennessee, have been involved in overearnings situations. The fuel for the engine of overearnings is, in most cases, access charges, and while a downward adjustment to those rates may alleviate the situation in the short term (more akin to a "mid-course correction"), the significant growth in toll usage virtually ensures that the company would likely be in another overearnings position in the near future.

While it has been assumed over recent years that local service requires a subsidy, most jurisdictional authorities have not required that sufficient proof in the form of specific cost studies be provided that would indicate the degree to which such support is actually needed. In those cases, then, the local exchange company may be deriving excess funds to divert to other purposes from excess rates charged to other carriers, and subsequently to users of toll services.

Third, any alternative provider considering competing with United for its intra-market toll service soon realizes that no competitor can match United's $0.03 per minute toll price and still make any profit since United's access charges are about $0.0539 per minute and will increase to about $0.05678 per minute if their net increase is approved by the TRA in this proceeding.

Q. WHAT SPECIFIC ACCESS RATE CHANGES HAVE OCCURED, OR ARE PROPOSED, IN TENNESSEE SINCE JANUARY 1, 1997?

A. The access changes implemented by United in Tennessee are specifically described on Exhibit GMH-2, and include changes proposed by United in this docket, along with other, concurrent changes. A summary of the changes is as follows:

1. In this docket, a reduction of the Terminating Carrier Common Line Charge (TCCL) and the Residual Interconnection Charge (RIC) is scheduled for May 15, 1997. The impact on AT&T is estimated to be a decrease of $762,600 annually.

2. The elimination of an access credit ordered by the Tennessee Public Service Commission as a result of United's overearnings case, Docket No. 93-04818. The impact on AT&T is estimated to be an increase of $913,400 annually.

3. An increase in the per-minute allocation to support Dual-Party Relay (DPR). The impact on AT&T is estimated to be an increase of $120,00 annually.

The net of the above three actions is an increase of AT&T's access expense by approximately $270,800 annually.

Q. WHAT SPECIFIC COMMENTS DO YOU HAVE REGARDING THE ABOVE THREE ACTIONS BY UNITED IN THIS CASE?

A. In the case of the decrease of the TCCL and the RIC, the decreases lower United's rate for these elements closer to their interstate level which was viewed as desirable by the TPSC in their Order at the conclusion of United's overearnings case (Order in Dockets 93-04818, 94-00388 and 94-00389, dated December 30, 1994, page 17). However, with competition evolving in all areas of telecommunications, access must be lowered to cost-based levels. Potential competitors must be afforded access services, not only on the same conditions as the local exchange company, but at a price that reflects the cost to provide the service. Access charges should be set at TELRIC rates, which will fully compensate United for the use of those facilities including joint and common costs, and will include reasonable profit.

The removal of the access credit, while provided for in the Order in Case 93-04818, is inappropriate due to the need to stimulate competition as discussed in the preceding paragraph. In addition, there is absolutely no indication that the access revenue is necessary to allow United to comply with current universal service and rural availability obligations. It is more likely that this access amount has been more than recovered by United from access growth in the two years that the reduction was in effect.

Regarding the increase in Dual Party Relay allocations, I realize that this allocation is the result of a state-wide calculation by BellSouth, the administrator of the fund. However, since the new allocation is nearly double the previous per-minute rate with no readily apparent reason for such an increase, AT&T is investigating why such an increase occurred. Up to this time, AT&T has been unable to secure backup material supporting the increase. Nonetheless, the new rate increases AT&T's access payments to United by about $120,000 annually and is of serious concern to AT&T.

Q. DO YOU HAVE SPECIFIC RECOMMENDATIONS REGARDING INTRASTATE SWITCHED ACCESS RATES FOR UNITED?

A. Yes. I recommend that the TRA require United to submit TELRIC cost studies covering the costs United incurs to provide intrastate switched access service. In addition, United should be required to submit to the TRA cost studies that indicate the actual expense United incurs to provide local exchange telephone service along with a complement of the revenue collected from all sources that may be used to support local telephone service. These revenue sources include, but are not limited to:

1. Basic Local Service
2. Vertical Features
3. Access Revenue
4. Any Universal Service funding from either state or interstate sources.
5. Toll revenue
6. Any add-on local features (additional listings, caller ID, caller ID blocking, etc.)

Once this information is available, the TRA can make an informed assessment of the amount of revenue required by United to support local service, and can then set access rates accordingly, according to TELRIC principles.

The first step toward cost-based access rates would entail the elimination of those elements that are comprised of subsidies, e.g., the carrier common line charge and the residual interconnection charge. The remaining traffic-sensitive elements (such as local switching and transport rates) should then be priced using TELRIC principles.

Q. HOW DOES UNITED'S INTRA-MARKET TOLL RATE OF $0.03 PER MINUTE DETER THE ENTRANCE OF COMPETITION FOR INTRA-MARKET TOLL SERVICES?

A. It denies consumer choice by retarding the introduction of competition in United's intra-market area. Additionally, and as I pointed out in the United overearnings case when their toll rate was $0.05 per minute, it causes customer confusion due to illogical variances between rates for similar calls within Tennessee.

Q. WOULD YOU EXPLAIN WHAT YOU MEAN BY CUSTOMER CONFUSION?

A. In order to illustrate this customer confusion, I am repeating an illustration that I included in my testimony in the United earnings investigation case, Docket No. 93-04818, in 1994, and updated for current rates and calling options. As illustrated in Exhibit GMH-3, customers in United's serving territory experience vastly different charges for toll calls placed within Tennessee. For example, the charge for a five-minute daytime toll call from Johnson City to Bristol and handled by United is $0.15. The same call handled by AT&T is $0.65, or over four times the United rate. Another intrastate call, from Johnson City to Nashville carries a charge of $1.05, seven times as much as the United rate. Few customers are aware of United's specific local exchange company boundaries and do not understand why the price of toll is so much higher to points outside United's serving area. On the other hand, most customers easily understand interstate calling for obvious reasons. Yet there is less rate disparity between an intrastate call from Johnson City to Nashville and an interstate call from Johnson City to Washington, D. C. As Exhibit GMH-3 demonstrates, the call to Nashville costs $1.05 versus a call to Washington D. C. which costs $1.50 or only 40 percent more.

Q. WHY DO YOU NEED COMPETITION IN THE INTRA-MARKET AREA WHEN TOLL IS PRICED AT THREE CENTS PER MINUTE?

A. The beneficial effects of competition go beyond driving prices towards cost. It results in greater choice for consumers. Competition brings new entrants to the marketplace who in turn invest in new technology and offer alternative plans and services. New technology brings the ability to move information in the most economical manner to the public and will eventually result in technological advances, i.e., the "information superhighway".

Q. IN SUMMARY, WHAT IS AT&T REQUESTING?

A. AT&T is asking for an access rate design which does not discriminate between classes of customers and which is based on the cost of providing the service. TELRIC is the best method of determining costs to be used as the basis for prices in a competitive environment. In terms of the $0.03 intra-market rate in United's territory, competition could best be served if competitors are able to enter this market with, at least, some chance of a profit. This could be accomplished by reducing the access rates that competitors must pay for the essential connection to United's customers, and by requiring United to offer intra-market toll at a rate that is more reflective of the cost to provide the service – rates developed using TELRIC principles.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.

WHOLESALE PRICES
VERSUS
ILLUSTRATIVE COSTS

	TENNESSEE UNITED (per minute)
CURRENTLY TARIFFED PRICES FOR TWO ENDS OF SWITCHED ACCESS	$0.0540
ILLUSTRATIVE COSTS FOR TWO ENDS OF SWITCHED ACCESS	< $0.0100
DIFFERENCE	$0.0440

SPRINT/UNITED PRICE CAP FILING, 9/12/1996
ACCESS PRICE CHANGES IMPACTING AT&T

DATE	OCCL	TCCL	DPR	ACCESS CREDIT	LS2	INFO SRCHG	LOCAL TRNSP	RIC	TOTAL T.S.	ORIG. + TERM.	AT&T $$IMPACT$$
9/11/96	0.009315	0.025110	0.001810	-0.010606	0.007404	0.000194	0.003176	0.003480	0.014254	0.053936	NONE
9/12/96 PRICE CAP (ERROR)	0.009315	0.015369	0.001810	-0.010606	0.007404	0.000194	0.003176	0	0.010774	0.037234	-$1,459,000.00
12/6/96 PRICE CAP (CORRECTION)(ERROR)	0.009315	0.01857	0.001810	-0.010606	0.007404	0.000194	0.003176	0.003315	0.014069	0.047065	-$577,674.00
12/6/96 ELIMINATION OF CREDIT	0.009315	0.01857	0.001810	0	0.007404	0.000194	0.003176	0.003315	0.014069	0.057673	$813,400.00
12/6/96 RAISE DPR	0.009315	0.01857	0.00323	0	0.007404	0.000194	0.003176	0.003315	0.014069	0.059293	$120,000.00
1/26/97 THIRD PRICE CAP FILING (EFF. 5/15/97)	0.009315	0.01857	0.00323	0	0.007404	0.000194	0.003176	0.002058	0.012632	0.056779	-$762,600.00

TOLL CALL COMPARISON
UNITED/SPRINT VS AT&T

	5 MINUTE CALL **DAYTIME RATES**
UNITED INTRALATA JOHNSON CITY TO BRISTOL, TENNESSEE	$0.15
AT&T INTRALATA JOHNSON CITY TO BRISTOL, TENNESSEE	$0.65
AT&T INTERLATA JOHNSON CITY TO NASHVILLE, TENNESSEE	$1.05
INTERSTATE JOHNSON CITY, TENNESSEE TO WASHINGTON D.C.	$1.50

AFFIDAVIT

STATE OF GEORGIA

COUNTY OF FULTON

BEFORE ME, the undersigned authority, did come and appear G. Michael Harper, who, after being duly sworn, did depose and say that he prepared the foregoing testimony consisting of 12 pages and three (3) exhibits for Tennessee Docket No. 96-01423, and that it is true and correct to the best of his knowledge and belief.

G. Michael Harper

G. Michael Harper

Sworn to and signed before me
this 13 day of February 1997

NOTARY PUBLIC Joyce Harris

CERTIFICATE OF SERVICE

I, Val Sanford, hereby certify that a true and exact copy of the foregoing Testimony of G. Michael Harper on behalf of AT&T Communications of the South Central States, Inc. has been served on the following counsel of record, this 14th day of February, 1997, either by hand-delivery or by placing a copy of the same in the U.S. Mail, postage prepaid, and addressed as follows:

James B. Wright
United Telephone-Southeast, Inc.
14111 Capital Boulevard
Wake Forest, NC 27587-5900

Richard M. Tettelbaum
Citizens Telecommunications Company of Tennessee, L.L.C.
Suite 500, 1400 16th Street N.W.
Washington, DC 20036

James B. Wright
United Telephone-Southeast, Inc.
14111 Capital Boulevard
Wake Forest, NC 27587-5900

L. Vincent Williams
Office of Attorney General
Consumer Advocate Division
426 Fifth Avenue North, Second Floor
Nashville, TN 37243-0500

Guy M. Hicks
BellSouth Telecommunications, Inc.
333 Commerce Street, Suite 2101
Nashville, TN 37201-3300

Val Sanford