BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of Petition of ICG Telecom Group, Inc. for arbitration of unresolved issues in interconnection negotiations with BellSouth Telecommunications, Inc.	DOCKET NO. 990691-TP

VOLUME 3
Pages 219 through 386

PROCEEDINGS: HEARING

BEFORE: COMMISSIONER J. TERRY DEASON
COMMISSIONER SUSAN F. CLARK
COMMISSIONER E. LEON JACOBS

DATE: October 7, 1999

TIME: Commenced at 9:30 a.m.
Concluded at 6:30 p.m.

LOCATION: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JANE FAUROT, RPR
NOTARY PUBLIC IN AND FOR
THE STATE OF FLORIDA AT LARGE

APPEARANCES:

(As heretofore noted.)

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I N D E X

WITNESSES

EXHIBITS - VOLUME 3

P R O C E E D I N G S

(Transcript continues in sequence from Volume 2.)

COMMISSIONER DEASON: Call the hearing back to order.

Mr. McGlothlin.

MR. McGLOTHLIN: Commissioner Deason, as a preliminary matter, we have distributed a list of the decisions of the state commissions and federal court decisions bearing on reciprocal compensation issues. We would ask the Commission to take official recognition of these decisions. We are hopeful that we will have the copies of the decisions themselves this afternoon. Apparently there was a Fed Ex snafu, some kind of delay in that.

If we don't have it today, we will commit to give it to staff and BellSouth no later than tomorrow.

COMMISSIONER DEASON: Okay. BellSouth.

MR. EDENFIELD: BellSouth has no objection. Although I have to note I don't necessarily agree with the heading, certainly the cases I have no objection with.

COMMISSIONER DEASON: I assume the cases speak for themselves, and there is no need to characterize them in any particular manner. Realizing that, we will identify this list as Exhibit Number 3.

Does staff have any objection to this list?

MR. FORDHAM: No objections.

COMMISSIONER DEASON: Very well. Since there is no objection, Exhibit Number 3 will be admitted into the record.

(Exhibit Number 3 marked for identification and received into evidence.)

COMMISSIONER DEASON: You may call your next witness.

MR. KRAMER: At this time ICG calls Cindy Schonhaut.

Thereupon,

CINDY Z. SCHONHAUT

was called as a witness on behalf of ICG Telecom Group, Inc., and having been first duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. KRAMER:

Q Would you please state your name and business address for the record?

A My name is Cindy Schonhaut, and my address is 161 Inverness Drive West, Englewood, Colorado.

Q And what is your position?

A I am Executive Vice President for Government and Corporate Affairs at ICG Communications.

Q And did you prepare or cause to be prepared the direct testimony of Cindy Z. Schonhaut in this matter?

A Yes.

Q Do you have any corrections to that testimony?

A Yes, I have a couple of corrections. The first is on Page 3, Line 7, there is a list of states where I have previously testified, and we need to delete the State of Colorado.

The next correction is on Page 11, Line 2. At the end of the line it says, "to any other traffic," and it should say, "to any other local traffic."

Those are my corrections for my direct testimony.

Q And as so corrected, if I asked you each of the questions contained in the direct testimony of Cindy Z. Schonhaut, would your answers to the questions be the same at this time?

A Yes.

MR. KRAMER: At this time I would move the admission of Cindy Schonhaut's prefiled direct testimony.

COMMISSIONER DEASON: Without objection, it shall be inserted into the record.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DIRECT TESTIMONY

OF CINDY Z. SCHONHAUT

ON BEHALF OF ICG TELECOM GROUP, INC.

DOCKET NO. 990691-TP

Q. PLEASE STATE YOUR NAME, ADDRESS, AND EMPLOYMENT.

A. My name is Cindy Zara Schonhaut. I am Executive Vice President for Government and Corporate Affairs for ICG Communications, Inc., the parent company of ICG Telecom Group, Inc. ("ICG"). My office is at 161 Inverness Drive West, Englewood, Colorado 80112.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND PROFESSIONAL EXPERIENCE.

A. I received my J.D. from the University of Miami School of Law, where I graduated with honors and was an editor of the Law Review. Previous to that, I received an undergraduate degree in social work from Syracuse University.

I have worked in the telecommunications industry for 19 years, particularly in the area of regulatory and legal affairs. As Executive Vice President, I handle all public policy issues for ICG at the federal, state, and local levels. I am also responsible for ICG's implementation of the Telecommunications Act of 1996 and parallel state laws, and negotiation of ICG's interconnection agreements with the incumbent local exchange carriers ("ILECs"). I joined ICG in February 1996 as a Vice President of the newly created Government Affairs department. I was promoted in December 1996 to Senior Vice President, and was again promoted in November 1998 to my current position.

Previous to my work with ICG, I held positions at MFS Communications Company, Inc. ("MFS") and the Federal Communications Commission ("FCC"). At MFS in Washington, D.C., I served for more than four years as Vice President of Government Affairs. In that role, I represented the company before the U.S. Congress, state legislatures, and regulatory agencies. I often served as an expert witness for MFS in state regulatory proceedings. In particular, I represented MFS before Congress in the period leading up to the passage of the Telecommunications Act of 1996.

Prior to my tenure with MFS, I served for 11 years as an attorney with the FCC. I was Legal Advisor for a commissioner and two Bureaus: the Common Carrier Bureau and the Mass Media Bureau. While at the FCC, I was a member of the task force that implemented the original access charges system and the divestiture of the Bell system. Following that, I was Special Counsel for joint board matters in the Common Carrier Bureau. I also served as a member of the Communications Staff Subcommittee of the National Association of Regulatory Utility Commissioners and acted as the FCC's liaison to all state regulatory agencies.

Currently, I serve as Vice Chair of the Board of Directors of the Competitive Telecommunications Association ("CompTel"), the leading trade association representing competitive telecommunications interests. I also chair CompTel's Regulatory Affairs Committee, a committee designed to provide a forum for competitive local providers. In addition to my work with CompTel, I am a member of the board of directors of the Association for Local Telecommunications Services ("ALTS").

Q. HAVE YOU TESTIFIED BEFORE STATE PUBLIC SERVICE COMMISSIONS IN THE PAST?

A. Yes, at various points in my career I have testified before the state commissions of Tennessee, Kentucky, Texas, Maryland, Ohio, California, Colorado, and Missouri.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

A. My purpose in testifying is to describe the dispute between ICG and BellSouth as it pertains to both the appropriate reciprocal compensation rate generally and reciprocal compensation for calls to ISPs. I will outline the potential consequences of these reciprocal compensation issues on the availability of a wide array of telecommunications options for the people and businesses of Florida. Ultimately, much of the disagreement of the parties about reciprocal compensation is fundamentally policy-oriented, rather than factual in nature. The resolution of this dispute, however, will have significant public policy implications for the development of local exchange competition throughout Florida. In some respects, the outcome of the reciprocal compensation disputes will be a primary factor in determining whether competition of local exchange service moves forward or becomes mired in the mud of an outdated regulatory system.

My testimony focuses on the compelling public policy justifications for providing reciprocal compensation for calls to ISPs at a rate that reflects the network functions ICG performs in delivering traffic from the BellSouth network to all customers – including ISPs – served by ICG's network. Another ICG witness, Michael Starkey, discusses the responsibility of the state commissions with regard to providing for reciprocal compensation and setting the appropriate rate in his direct testimony, from an economics and regulatory perspective.

Q. DOES ICG PROVIDE SERVICE TO ISP CUSTOMERS?

A. Yes. ICG serves ISPs in many of the markets in which it currently operates.

Q. HOW HAS ICG WON ITS ISP CUSTOMERS?

A. ICG has simply stepped in to provide the new and innovative services necessary to serve a market the ILECs were ignoring. Before alternative local exchange carriers ("ALECs") began to offer local exchange service, ISPs and other end users with specific service needs were dependent exclusively on the ILECs – the monopolist providers of such services. Without competitive pressures, the ILECs offered "one size fits all" service at high rates. Often the "size" offered to ISPs was one that barely fit its operations.

Compared to the ILECs, ICG has frequently been able to offer ISPs service packages that are carefully tailored to the ISP's operators. For example, ICG has led the way in offering volume and term discounts to ISPs. ICG has gone beyond offering simple delivery to the ISP's demarcation point and has provided turn-key solutions to ISP needs. ISPs have also been attracted by ICG's superior network, which consists entirely of digital switching and fiber optic transport facilities, as opposed to the analog/digital switching and a hybrid of fiber, microwave, and copper network transport facilities offered by the typical incumbent. In addition, ICG offers ISPs the option of collocating ISP equipment alongside ICG equipment in ICG's central office.

Before the advent of local competition, high bandwidth options were expensive and the penetration low. Without the arrival of ICG and other ALECs, there is no reason to believe that the ILECs would have been spurred to develop their own new technology and service offerings, such as ISDN lines, digital subscriber lines, and packet-switching capabilities. Today, ICG continues to be at the forefront of serving ISPs as well as other businesses that have specific or advanced telecommunications needs.

Q. HOW WOULD THE LACK OF RECIPROCAL COMPENSATION FOR CALLS TO ISPs HARM ICG?

A. The impact of no reciprocal compensation for a significant amount of traffic that ICG terminates to end users would be felt across ICG's operations. Without reciprocal compensation for delivering traffic to ISPs, ICG and other ALECs would be left to raise their rates or absorb their costs – either of which would be destructive to their ability to attract and keep customers. The remaining option would be to decline to provide service to ISPs. All of these possible responses would endanger the competition that is critical to fostering an advanced public switched telephone network and a menu of service offerings that would meet the needs of all end users – whether business end users or individuals.

In addition, with reciprocal compensation for calls to ISPs precluded as a source of revenue, ICG would find it necessary to weigh whether it would be a wise business decision to provide service to ISPs and their customers in Florida, or whether ICG would be better off solely serving other end users with large volumes of incoming calls, such as pizza delivery services or local chat lines. Another possibility for ICG to weigh in an environment of no reciprocal compensation would be to simply forego the particular market. Consequently, the improvements in rates and services that would result from ALEC competition would be lost.

Precluding reciprocal compensation for calls to ISPs that ICG terminates on behalf of BellSouth would deny ICG payment for the service it provides. ICG would incur a cost for which it would never be compensated, not even when the FCC adopts its rules on compensation for ISP traffic, which will be prospective in application. BellSouth, for its part, would avoid the cost of terminating the call and would therefore come out ahead. Without receiving fair compensation for the service it provides its competitors, ICG would be significantly handicapped in the competitive marketplace and would likely reassess its plans for business in this state. In this regard, ICG is not requesting special treatment, but only that it be allowed to recoup its costs incurred on behalf of other carriers, as ICG would for any other calls ICG terminates.

Q, WHAT ABOUT THE EFFECT ON ISPs?

A. If ALECs are forced to raise their rates to ISPs because the ALECs are not recovering the cost of terminating the traffic, it could result in increased costs to end users of ISP services. There is no way of knowing how ISPs would handle rate increases, and whether ISP rate increases would artificially suppress demand for services in such a way that the growth of the Internet in this state would not reach the levels it otherwise would have. If, as I have discussed above, ALECs reassessed their willingness to provide service to ISPs, ISPs would be left without any bargaining leverage to negotiate more favorable rates and necessary services, and all ISP customers would suffer as a consequence.

Q. DOES BELLSOUTH HAVE A PARTICULAR INCENTIVE TO RESIST PAYING ICG RECIPROCAL COMPENSATION FOR ISP TRAFFIC?

A. Yes. Another witness, Michael Starkey, discusses BellSouth's incentives at length in his testimony. In brief, BellSouth apparently recognizes that any carrier that can avoid paying compensation to other carriers for the completion of local calls originated by its end user customers will have a competitive advantage. As an established ILEC with a diversified customer base, BellSouth seeks to limit its exposure to reciprocal compensation for local calls delivered to end user ISPs who may be targeted by its competitors. While its incentive may be natural, however, the consequences of this Commission allowing BellSouth to avoid such payments would be competitively disastrous, as I have outlined above with regard to ICG's options if faced with such an outcome.

Q. WHAT IS THE ROLE OF THE COMMISSION IN RESOLVING THE DISPUTE ABOUT RECIPROCAL COMPENSATION FOR ISPs?

A. The role of this Commission is to make a policy decision that will have a fundamental impact on the development of the internet in this state. This

Commission's decision will help determine whether competitors enter the local market and, if they choose to do so, which customers they will serve – Internet and high tech customers who bring the benefits of the information age to end users or the more typical end users who simply have high volumes of incoming calls.

Q. WHAT IS THE ROLE OF THIS COMMISSION WITH REGARD TO RECIPROCAL COMPENSATION FOR ISP-BOUND TRAFFIC IN LIGHT OF THE FCC's RECENT RULING?

A. Although the FCC's Declaratory Ruling and Notice of Proposed Rulemaking in CC Docket 96-98, released on February 26, 1999 ("FCC Ruling"), found that calls to ISPs when exchanged between two carriers within the same local calling area in a state are "jurisdictionally mixed and appear to be largely interstate[,]" the FCC concluded that calls are to be *compensated* in accordance with the actions of the state commission unless and until the FCC adopts a further order governing compensation. Any FCC Order will have prospective application only.

The FCC Ruling makes it abundantly clear that a state commission's ordering of reciprocal compensation in an arbitration proceeding is consistent with federal policy until the FCC adopts a rule. The FCC stated repeatedly in its Ruling that "[c]urrently, the Commission has no rule governing inter-carrier compensation for ISP-bound traffic." Id. at ¶ 22. In addition, the FCC suggested in its Ruling that it was appropriate for a state to provide for reciprocal compensation as long as there continues to be no federal rule. The FCC stated further that:

> In the absence of a federal rule, state commissions that have had to

> fulfill their statutory obligation under Section 252 to resolve interconnection disputes between incumbent LECs and CLECs have had no choice but to establish an inter-carrier compensation mechanism and to decide whether and under what circumstances to require payment of reciprocal compensation...
>
> ...*[N]either the statute nor our rules prohibit a state commission from concluding in an arbitration that reciprocal compensation is appropriate* [for traffic] not addressed by section 251(b)(5), so long as there is no conflict with federal law. *A state commission's decision to impose reciprocal compensation obligations in an arbitration proceeding ... does not conflict with any [FCC] rule regarding ISP-bound traffic.*

FCC Ruling at §26 (emphasis added). Therefore, a determination by this Commission to impose reciprocal compensation pending promulgation of a federal rule at some point in the future not only would " not conflict with any [FCC] rule regarding ISP-bound traffic," it would help to ensure equity until the FCC resolves how ALECs will get paid for calls to ISPs.

Q. WHAT WOULD BE THE CONSEQUENCES OF THIS COMMISSION CHOOSING TO AWAIT THE COMPLETION OF THE FCC's RULEMAKING PROCEEDING ON COMPENSATION FOR ISP-BOUND TRAFFIC?

A. Without action by this Commission, ICG will not receive any compensation for calls to ISPs; until the time the FCC finally promulgates a rule, ICG will be unable to recover its costs of carrying calls to ISPs on behalf of end users served by

BellSouth. The FCC has not indicated its timeline for adopting a rule, which could be months or even a year away. This means that ICG would be uncompensated for a significant amount of traffic that it carries every day for the indeterminate future. In addition, because the FCC's rule will be prospective only in application in this state, ICG will *never* receive compensation for delivering calls to ISPs without a ruling by this Commission in ICG's favor. The foreclosure of this source of revenue would threaten ICG's ability both to compete in Florida as well as to provide service to ISPs and their end users. Without compensation for ICG's costs in serving a significant category of its customers, ICG could be forced to re-think its options concerning its planned operations in this state.

Q. HOW SHOULD THIS COMMISSION SET THE RECIPROCAL COMPENSATION RATE FOR CALLS TERMINATED BY ICG ON BEHALF OF BELLSOUTH?

A. The Commission should establish a reciprocal compensation rate that recognizes that ICG's network performs a similar function and serves a comparable geographic area to that served by the BellSouth tandem. As such, the rate paid to ICG by BellSouth for reciprocal compensation should recover ICG's costs of providing the same tandem, transport, and end office functions that BellSouth provides in terminating a call from ICG. As Mr. Starkey describes in more detail in his testimony, to ensure symmetrical compensation between ICG and BellSouth, the appropriate rate for ICG's termination of BellSouth traffic would be the sum of the BellSouth tandem switching, transport and end office switching rate elements.

Q. WHAT RECIPROCAL COMPENSATION RATE SHOULD APPLY TO ISP

TRAFFIC?

A. The same reciprocal compensation rate that is applied to any other traffic. As I have mentioned, and as Mr. Michael Starkey explains in greater detail, the functions performed by ICG's network are the same when it delivers a call from BellSouth's customer to ICG's ISP customer as when ICG terminates any other call. Accordingly, the same rate should apply.

Q. PLEASE SUMMARIZE YOUR TESTIMONY ON THE IMPORTANCE OF THE RELIEF SOUGHT BY ICG.

A. It would be sound public policy to grant the relief sought by ICG. If local competition is to continue to develop and expand, it is necessary to achieve efficient interconnection of competing service providers. As an integral part of this interconnection, service providers will need to terminate traffic on each other's network, making reciprocal compensation critical to recovering the costs associated with terminating a call obtained from another provider. Without action by this Commission, ICG will not receive any compensation for calls to ISPs; until the time the FCC finally promulgates a rule, ICG will be unable to recover its costs of delivering calls to ISP customers on behalf of end users served by BellSouth. The Commission's decision has significant implications for the future of the competitive market for local services and the development of Internet services in this state. More generally, this Commission should set a symmetrical, reciprocal compensation rate that allows ICG to recover costs equal to those recovered by BellSouth when ICG terminates traffic to its tandem locations. Although it is by now an obvious point, it bears repeating that the resolution of this arbitration issue will ultimately have a significant impact on the people and businesses of Florida and the range of telecommunications options open to them.

Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY AT THIS TIME?

A. Yes.

BY MR. McGLOTHLIN:

Q Ms. Schonhaut, have you prepared a summary of your testimony?

A Yes, I have.

Q Could you please give the summary to the Commission?

A Yes.

Commissioners, my direct testimony focuses on the issue of reciprocal compensation for calls to Internet Service Providers, or ISPs. I first describe why it is critical that this Commission require BellSouth to pay reciprocal compensation for ISP-bound calls, and the serious consequences for competition in Florida that will result if reciprocal competition does not apply to ISP traffic.

If ICG is unable to recover the costs that we incur in delivering BellSouth traffic to our ISP customers, our ability to bring innovative reasonably-priced services to ISPs will be seriously impaired.

And in my testimony I then turn to the Commission's authority to address reciprocal compensation. And I explain that the FCC's declaratory ruling of February 1999 not only provides the Commission with the authority to require reciprocal compensation for ISP traffic, but also makes clear that to require such compensation is the correct policy result.

To understand why reciprocal compensation for ISP traffic is critical, it is important to understand why ICG has been as successful as it has in obtaining ISP customers in other markets. ICG's success is due in large part to the vacuum left in the market by BellSouth's failure to offer ISPs the specialized cutting-edge services they need at prices that make sense for them.

Without competitive pressures, BellSouth and the other incumbent LECs offered a one-size-fits-all service at high rates. ICG, by contrast, has been able to offer ISPs service packages that are carefully tailored to meet the ISPs' needs.

If reciprocal compensation is not required for ISP calls, it would have a dramatic effect on the ability of ICG to continue to bring innovative high value services to ISPs and also to other technologically demanding customers. If ICG is unable to recover from BellSouth the cost of delivering calls from BellSouth customers to the ISPs served by ICG, we would be left to raise our rates or absorb those costs.

Both of these options would be detrimental to our ability to attract and keep customers. The only other possibility left to us would be to decline to provide service to ISPs in Florida. Obviously, each of these possible outcomes would endanger the very competition that is critical to fostering the development of the Internet and advanced telecommunication service offerings in the State of Florida.

The ultimate losers would be Florida consumers. If ICG is forced to raise its rates to ISPs because we cannot recover the cost of delivering the traffic from BellSouth, it could result in higher prices for end users of ISP services. This result would, in turn, artificially suppress demand for services in such a way that the growth of the Internet in this state would not reach the levels it otherwise would have.

While ICG, ISPs, and users of the Internet would all suffer if BellSouth is not required to pay reciprocal compensation, BellSouth stands to gain. If reciprocal compensation is not available for calls to ISPs that ICG delivers on behalf of BellSouth, we will incur significant costs for which we would never be compensated.

BellSouth on its part would avoid the cost of delivering the call to us and would therefore come out ahead. The consequences of the Commissions allowing BellSouth to foist its costs off on ICG in this manner would be completely disastrous.

In my testimony, having described why it is critical that this Commission order reciprocal compensation for ISP calls, I then address whether the Commission has authority to do so in the interim period after the FCC's February declaratory ruling, but before the FCC issues its pending final ruling. That the answer to that question is yes could not be clearer, despite BellSouth's attempt to confuse the issue.

Although the FCC's declaratory ruling found that calls to ISPs are jurisdictionally mixed and appear to be largely interstate, the FCC concluded that state commissions have authority to require compensation for those calls until the FCC adopts a further order governing compensation issues.

Let me quote from Paragraph 26 of the declaratory ruling. Neither the statute or our, that is the FCC's rules, prohibit a state commission from concluding in an arbitration that reciprocal compensation is appropriate for traffic not addressed by Section 251(b)(5), that is traffic that is not local, so long as there is no conflict with federal law. A state commission's decision to impose reciprocal compensation obligations in an arbitration proceeding does not conflict with any FCC rule regarding ISP-bound traffic.

I then go on in my testimony to say that if the Commission does not act to require reciprocal compensation, ICG will be unable to recover its costs of carrying BellSouth traffic to our ISP customers during the interim period, which we are in now, before the FCC acts. The FCC has not said when it intends to issue its ruling. It could be months or even a year or more from now. There is no deadline.

This delay means that ICG would be uncompensated for a significant amount of traffic for the indeterminate future unless this Commission requires the payment of reciprocal compensation. In addition, because the FCC's rule will be prospective only in application, if the Commission does not act now, ICG will never receive compensation for delivering calls to ISPs in the interim before the FCC's new rule is in place.

Foreclosing this source of revenue would be a severe blow to ICG's ability to compete effectively in Florida.

Thank you. That concludes my summary.

MR. KRAMER: The witness is tendered for cross at this time.

COMMISSIONER DEASON: BellSouth.

MR. EDENFIELD: May I proceed?

COMMISSIONER DEASON: Yes.

CROSS EXAMINATION

BY MR. EDENFIELD:

Q Ms. Schonhaut, let me talk for just a couple of minutes about ICG.

ICG is headquartered in Denver, Colorado, is that correct?

A Yes, in the Denver area. It's actually the town of Englewood.

Q Right outside of Denver?

A Yes.

Q Does ICG currently provide facilities-based services in the State of Florida?

A No.

Q Does ICG currently provide resale services in the State of Florida?

A No.

Q Does ICG have any facilities in Florida, and by that I'm referring to switches and/or transport facilities?

A No.

Q Does ICG have any plans to provide facilities-based or resale service in Florida this year?

A Actually, we do.

Q In 1999?

A Yes.

Q Is that inconsistent with what I heard earlier that said second quarter of 2000? Was there a mistake earlier?

A I believe so. I think I have more current information than Phil had available to him.

Q Is that part of your business plan for 1999?

MR. KRAMER: Your Honor, I'm going to object.

I mean, I will allow the witness to answer questions, a couple of specific questions regarding some plans for Florida, but obviously business plans, and exactly what our plans are, and how we intend to configure is very proprietary and very confidential, and we are not at all comfortable revealing that information.

To the extent the witness is comfortable, again, revealing some limited information about our plans for Florida, that is fine. But I don't want that to be construed as a waiver of our objections on grounds of proprietary and confidentiality.

Subject to that caveat, I will -- if Mr. Edenfield wants to rephrase the question to ask her not a specific question about our business plan, but whether we intend to operational in 1999, I would not object.

MR. EDENFIELD: I have asked this question in two other states and never gotten an objection. I understand this is a different proceeding, but certainly I think ICG's business plan is relevant to what we are doing.

COMMISSIONER DEASON: To the extent the witness feels comfortable answering the questions, I will permit the question and the answer. If the witness feels that to be responsive to the question that it would necessitate revealing confidential information, I will let the witness so state and we will review that at that time.

THE WITNESS: Okay. Could you please read the question.

BY MR. EDENFIELD:

Q Let me see if I can do this again. Does ICG's current business plan, the business plan for 1999, did it or does it provide for providing service in Florida in the year 1999?

A Yes.

Q It does?

A Yes.

Q Is that a written business plan?

A Yes.

Q Do you have a written business plan for the year 2000?

MR. KRAMER: I'm going to object.

COMMISSIONER DEASON: She can acknowledge whether she has the plan or not, counselor.

MR. KRAMER: All right.

THE WITNESS: Yes.

BY MR. EDENFIELD:

Q Does your business plan call for the continuing of providing business in the State of Florida for the year 2000?

A Yes, it actually calls for increasing it.

Q All right. As I understand your background, you are an attorney?

A Yes.

Q Graduated from the University of Miami?

A Right. University of Miami of Florida.

Q Are you going to stay in town for the big game this weekend?

A Oh, I don't want to get into that controversy.

Q After graduating from law school, you spent eleven years with the FCC, as I understand it?

A Approximately, yes.

Q You were an attorney with them?

A Yes.

Q And for four years after that you were with an ALEC called MFS?

A Yes. Closer to five years, yes.

Q And for the last four years you have been with ICG, and currently hold the position of executive vice president?

A Executive vice president.

Q Of government --

A And corporate affairs.

Q All right. Let's talk about unbundled network elements for a minute.

Do you agree that Rule 51.319, which is the FCC's UNE list, was vacated by the Supreme Court and is currently under reconsideration by the FCC?

A Yes, I agree. The FCC has voted its decision in that remand case last week -- just recently. They haven't issued the order yet, but they did vote on that case.

Q There has been no order issued as we sit here today?

A Not to my knowledge.

Q Do you agree that until such order is issued that there really is no list of FCC-approved UNEs?

A No, I disagree. There is a list of the UNEs. There are six that will be required in the FCC's press release. And also the FCC at its public meeting, at its agenda meeting discussed at length with staff and amongst themselves in public what is going to be required in the order.

Q As an attorney, do you think a press release has the same effect as an order?

A No, I didn't. You didn't ask me -- it doesn't have the same effect. The press release is an unofficial document. The order itself is obviously an official document. However, given that we are 3-1/2 years, almost four since passage of the Telecom Act, and given the controversy that inspired this litigation over UNEs and the fight with the Bell companies, including BellSouth in the courts over being required to provide anything at all, I think it is safe to assume that something is going to be required of the Bells. It is going be what is in the press release and even more.

And at this point in time it is very difficult to comprehend why the Bell companies just won't concede that there are six UNEs that will be required in short order.

Q My question was a lot more narrow than that. My question was as an attorney, do you believe that an order is required before the UNE list becomes effective?

A Yes. I said the press release is unofficial and the order is official.

Q Okay. So then you agree that until an order comes out there is no official list of UNEs which BellSouth is required by law to provide?

A Yes.

Q Do you agree that the Eighth Circuit vacated the FCC's rules requiring BellSouth to combine UNEs for ALECs? Specifically, I'm referring to Rules 51.315, Subsection C through F?

A Yes, they were vacated and that appeal is still in the process. It's continuing.

Q And in the State of Florida are you aware that the Florida Commission has an ongoing generic UNE docket?

A Yes.

Q Is ICG a participant in that docket?

A No.

Q Why is ICG not a participant in that docket, if you're planning on doing business here?

A I'm sorry, I didn't hear the end of your question.

Q If you are planning on doing business here, why did you elect not to become a participant in that docket?

A Well, we are not a party ourselves, but we participate through the SECCA coalition, the Southeast Competitive Carriers Association, which is a way for several or many ALECS to combine their limited financial resources and make the same points. So we are participating in that way, although we are actually not a party.

Q Do you think it is a better policy for the Commission to decide these UNE issues such as the ones you have raised here on a piecemeal arbitration-by-arbitration basis or in one big generic proceeding?

A I think the Commission should decide the issue of UNEs in the arbitrations as they come up. If that is considered piecemeal, so be it. But prior to the issuance of an order by this Commission in the UNE docket, if the UNE issues are not -- the availability of UNE issues are not resolved in the arbitrations, then there will be an indefinite delay before any UNEs are available.

And I go back to my earlier concern. Since the summer or September, actually, of 1996, when the Eighth Circuit issued its order vacating the FCC's rules, there really have been no real requirements regarding what the Bell companies must do with respect to UNEs. And now they want to delay that even further, and we are well past the time when this should have been resolved. In fact, there are many fewer UNEs required than a lot of the competitors asked for. So we should just go forward and implement those UNEs.

Q Ms. Schonhaut, you are aware that BellSouth and the other RBHCs agreed with the FCC to continue to provide UNEs pending the outcome of that docket?

A I am aware. I saw those letters. BellSouth actually had a contingency in its letter which I don't recall now, but there was wiggle room.

Q As you sit here today, are you aware of anyone requesting a UNE on that list that has not been provided by an RBHC?

A No, I am not aware of that.

Q Now, in this SECCA representing you in the generic UNE docket, do you know whether they have raised the issue of volume and term discounts in that docket?

A I don't personally know whether they have.

Q Do you know whether they have raised the issue of EELs in that docket?

A No, I don't know.

Q Do you know whether they have raised the issue of packet switching in that docket?

A No, I don't have any direct knowledge, but I can -- I believe they would have raised these issues and many others.

Q Do you think that the Commission is served by having an opportunity to have the parties brief the upcoming FCC order prior to rendering a decision in this case or the UNE docket?

A To brief the FCC order. You mean comment on it, talk about it?

Q Certainly.

A I don't believe that that is necessary in order to decide the limited UNE issues that we have put forward in our petition for arbitration.

Q When is ICG set to start business this year, what is the date?

A When are we set to start business, you mean in

Florida?

Q I'm sorry, in Florida.

A In the fourth quarter in Miami.

Q Is that going to be through facilities-based competition, or is that going to be through resale?

A Through facilities-based, a combination of facilities-based and UNEs if we are able to obtain them.

Q Let's talk reciprocal compensation for a moment. Is ISP traffic local traffic or interstate traffic?

A It's not an either/or question. ISP traffic is jurisdictionally interstate, but for regulatory purposes, including compensation, it is treated as local. So it is sort of both.

Q What is the difference between a jurisdictional treatment and a regulatory treatment?

A Many differences. Primarily deciding with respect to -- their is jurisdiction, obviously. FCC versus the State Commissions, but in addition it is primarily raising a controversy because it relates to price. That is the bottom line. And that is to say that if it is an interstate service, there are only basically a couple of kinds of interstate services, toll and access, and they have certain prices and certain regulatory regimes.

Jurisdictionally, what the FCC did is they said although they have jurisdiction over this traffic, they are not going to subject the traffic to those regulatory regimes that they have in place for those other types of interstate traffic. And that it would be up to the state commissions to invoke their authority and their regulatory schemes in how they treat this traffic because it is to be local. So that, therefore, the states have jurisdiction to decide how it is to be regulated.

Q Did the FCC, in essence, say that the traffic, ISP traffic, is interstate traffic, but for certain purposes it is going to be treated as local traffic?

A I wouldn't phrase it that way. They definitely said this is interstate in nature, largely interstate. I read something in my summary, I believe, that said that. But they said very specifically that for regulatory purposes, in particular for the issue of reciprocal compensation between ILECs and CLECs, that this traffic is to be treated as local.

Q Right. The interstate traffic is to be treated as local, is that what you're referring to?

A Yes.

Q Just because you are treating ISP traffic as local, is it your contention that that makes it local traffic?

A Well, we are using the terms local and interstate. In a regulatory world, which has its own definitions, it is not colloquial terms like looking at a map. So I suppose I would say yes. But, I mean, the whole point is that these names, these nomenclatures relate to who has jurisdiction and who pays what, how much, to whom. That's what really matters.

And a lot of regulation, in particular perhaps from the FCC, has very strange constructs and fits round pegs into square holes. That is very common, and we have all lived with that, and the courts have upheld it. As recently as approximately a year ago, the Eighth Circuit upheld this sort of dual construct of the FCCs with regard to ISP traffic.

Q Do you agree that Florida's previous rulings on ISP traffic really are of no moment here as far as determining a going-forward intercarrier compensation plan?

A I wouldn't say of no moment. I think they are relevant, certainly, and instructive, illuminating, useful. They provide many things. I think you may be getting at are they controlling precedent as a legal matter, and probably the answer to that is no, but that doesn't mean they are of no moment.

Q You agree that -- are you familiar with those decisions at all?

A Yes, I read them awhile ago.

Q So you would agree, then, I take it, that the basis for those decisions was a finding by the Commission that there was an intent on BellSouth's part to include ISP traffic within the definition of local traffic?

A That was part of the basis of the decision. I don't think it was the sole -- of the decisions, I don't think that was the sole basis, but it was definitely a factor.

Q And I assume you would agree here that BellSouth does not intend to include ISP traffic within the definition of local traffic?

A I will have to agree with that.

Q Going back to this jurisdiction/regulatory issue, which of those two determines who is in charge of the traffic from a regulatory body standpoint?

A In charge of the traffic from a regulatory body standpoint. I'm not sure I know what that means, but I think I know what you are getting at. It is very clear that right now the FCC ruled and their order is effective that the states are to decide the compensation arrangement. I don't know if that is responsive to your question, but I tried to understand it as best I could.

Q I think it is getting there. Let me see if I can clarify it a little more. The FCC has the final say on traffic that is interstate in nature, would you agree with that?

A The final say.

Q In other words, it's the FCC's call. In other words, a state can't come in and preempt the FCC on interstate traffic decisions?

A Yes, you are right. Generally speaking that is true.

Q And by the same token for traffic that is, you know, what I call purely local traffic, the FCC does not really have the authority to come in and preempt a state decision?

A I don't know what you mean by purely local traffic.

Q Traffic that is within the pure jurisdiction of the state regulatory body, that that is within their purview and the FCC does not have the authority to come in and preempt them on those issues?

A The reason I am having trouble answering that question is because, yes, there is traffic and even in the Telecom Act identifies traffic that is exempted from FCC jurisdiction. It is not really -- exemption is the wrong word. It is clearly stated that the FCC doesn't have jurisdiction.

However, what the question doesn't take into consideration is that the same facilities and plant are used to provide local and interstate services. So, for example, the subscriber line charge, which is an interstate charge, is assessed sort of as a local charge. And there is a lot of overlap and mixture.

Q You agree, then, that the FCC has jurisdiction over ISP traffic?

A Yes.

Q And I'm not trying to be funny, but what the FCC giveth, it can taketh away. So tomorrow the FCC has the authority to come in and say, states, you no longer have the right to make any type of decisions or rulings in the area of ISP traffic. They could do that, could they not?

A Well, they could not do it tomorrow because they need to sunshine their meeting to vote. And I'm not trying to be cute, what I'm trying to say is that it is not much of a secret what the schedule and the work load is at the FCC, let alone state commissions. And the FCC often indicates publicly, the Chairman or the Bureau Chiefs when they are going to consider things.

And when they do announce that, it is almost certain that those dates will slip. So we don't expect a decision soon. I think that is a common feeling amongst the Bell companies even as well as the CLECs, like in Washington, so to speak. And so there is certainly a period of time before the FCC acts.

But more important than that, the FCC's order tentatively concluded to give the jurisdiction to the states essentially indefinitely. They said it has been the state's jurisdiction to date, the date of that order. The states continue to assert jurisdiction until the FCC decides otherwise, and when they are considering whether to decide otherwise, they tentatively concluded to leave it with the states. That we do know. That has been in writing.

And also in the proceeding, the weight of the comments, the vast majority of the comments support leaving it in the state jurisdiction, I think, with the exception of Bell companies, including BellSouth.

Q Are you suggesting that --

COMMISSIONER DEASON: Let me ask a question at this point. How is it that a regulatory agency can just choose to give its jurisdiction to someone else?

THE WITNESS: Well, actually, I have been thinking about that issue for 15 years, because I --

COMMISSIONER DEASON: Because there are some things I would like to give away, too, you know.

THE WITNESS: I was special counsel to the joint board when I was at the FCC, and at that time when I had that job in the late '80s, there were many what is known as preemption cases. A good example would be inside wire or shared tenant services.

These cases came up, and shared tenant services is a good example because that was at that time the beginning of the beginning of some competition with the incumbents on the local side. The FCC said that they had jurisdiction over shared tenant services, but they were going to leave it to the states to let the states experiment -- they used the word laboratory -- with different regulatory schemes and different either requirements or restrictions on shared tenant services in order to see how the market could flourish.

And then shortly thereafter, of course, the competitive access providers and later the ALECs kind of overtook those issues. And there have been a lot of different cases where things like that, where the FCC has said, well, you can't pull apart the intrastate from the interstate service. However, we are not choosing to regulate, the states can if they want to. And that is true for the Telecom Act, as long as they don't do anything inconsistent with the act.

And the FCC said in February of this year that for the states to require reciprocal compensation for ISP traffic --

COMMISSIONER DEASON: Let me interrupt just a second. I'm trying to draw a distinction, or maybe I'm getting a distinction in your answer that I need to clarify. Is it that the service itself has aspects of both interstate and intrastate and it is difficult to distinguish that and, therefore, it is a situation of one agency just relinquishing and saying we are not going to intercede, and the other regulatory agency, you do what you think is appropriate. Or is it a question of we have jurisdiction, it is interstate, but we are not going to do anything right now because we are not ready. In the meantime, states, you do what you want to and then we will overturn you when we are ready?

THE WITNESS: Well, I think we have seen both. The first scenario where this intrastate and the interstate services are inseparable or inseverable, I think is the term the Supreme Court used. I think it was a late '80s case of the U.S. Supreme Court where they cannot be pulled apart, then it stays in the interstate jurisdiction. And you could see a case where the FCC in those circumstances would, and they have said, well, states, you take it, essentially.

But we have also seen the other scenario where the FCC has said this traffic is so predominantly interstate, it is not that we can't pull apart the intrastate, but the intrastate is insignificant. And that is the reciprocal compensation decision, for example, from February. And they said, well, in this case we have jurisdiction because it is interstate. However, for various reasons, of course, they explained why they are going to leave it to the state jurisdiction to decide the compensation issue.

Now, it is obvious that the FCC didn't delegate authority to the states to regulate the Internet. I don't think anybody claimed that or even considered it. It is this issue of compensation between two telecommunications providers that was given to the states.

BY MR. EDENFIELD:

Q Ms. Schonhaut, are we talking about, and this kind of goes along with what Commissioner Deason was saying, and forgive me if we are covering old ground. Is this a situation where the FCC is exercising jurisdiction through the states, or is this a situation where the FCC has attempted to grant jurisdiction to the state, if you understand my distinction?

A If you could just repeat it. To grant jurisdiction, and what was the other?

Q The other was exercising its jurisdiction through state activity.

A Well, I'm not sure I know the answer to that. The FCC didn't use either expression in the declaratory ruling. They didn't use delegate or grant. They said the states are free to do such and such, so I wouldn't use those words actually.

Q If you have that cite in front of you, free to what?

A It may not have been a direct quote, but I will show you where it is.

Q It may be in Paragraph 26, but I'm not 100 percent sure. Forgive me. Do you have that in front of you, by the way?

A Yes, I do. I have the FCC order, and it is the -- it is the sentence that says in the absence of federal rule to the contrary. I apologize for having to find it.

Well, I mean, there are several sentences, but here is one. It is the first sentence of Paragraph 24. This is the sentence I was thinking of. Against this backdrop -- may I read from it?

Q Yes, I'm there. Thank you.

A Against this backdrop, and in the absence of any contrary Commission rule, that is the FCC Commission, parties entering into interconnection agreements may have reasonably agreed for the purpose of determining whether reciprocal compensation should apply to ISP-bound traffic, that such traffic should be treated in the same manner as local traffic.

Now, that is referring to when there is agreement between the parties or at least when somebody finds there was agreement.

Q Such as the prior Florida Commission decisions?

A Right. But as you continue

MR. KRAMER: I might also suggest you look at the bottom of Page 17 in Paragraph 26.

MS. SCHONHAUT: Thank you. That's where I was heading.

A (Continuing) Well, it is the next to the last -- it is the last sentence and the sentence that incomplete and continues. The FCC is saying, as we stated previously, the Commission currently has no rule addressing the specific issue of intercarrier compensation for ISP-bound traffic.

In the absence of a federal rule, state commissions that have had to fulfill their statutory obligation under Section 252 to resolve interconnection disputes between incumbent LECs and CLECs have had no choice but to establish an intercarrier compensation mechanism and to decide whether and under what circumstances to require the payment of reciprocal compensation.

Oh, here is the sentence. It is the last sentence in Paragraph 26. By the same token, in the absence of governing federal law, state commissions are also free not to require the payment of reciprocal compensation for this traffic and to adopt another compensation mechanism. That is where the word free was. I had remembered it.

Q Would you agree that the FCC, in requiring BellSouth for separations purposes to report the traffic as local and for the other instances in which BellSouth is required to sell out of -- the service out of the local tariffs, that these are all mandates by the FCC in exercising their jurisdiction over the traffic?

A Decisions, yes, mandates. Yes, they are orders. They are requirements, yes.

Q In other words, the manner in which BellSouth treats ISP traffic is as a result of the FCC telling us to do it that way?

A Well, I think one of the points is, though, and this is I think what you are getting at, to a certain extent the FCC has said, well, we, the FCC, will decide what to do. For example, with respect to separations or accounting, which generally does stay with the FCC, of course, in conjunction with the joint board. But the FCC for certain other purposes, and I am going to read the sentence in Paragraph 23 of the February order. And it is in the middle of the paragraph, it is the third sentence I think from the bottom, that says as such, as such the Commission discharges interstate regulatory obligations through the application of local business tariffs.

Obviously local business tariffs are the purview of this Commission to review and approve or investigate, yet at the same time the FCC was saying the federal separations rules apply to the same traffic. And we have lived with this sale situation now for about 15 or more years.

Q Is it your opinion as a lawyer that one state -- I'm sorry. Let me start that over. As a lawyer, that one government agency has authority in and of itself to grant jurisdiction to another government agency, absent some mandate from either Congress or a state legislature?

A In this case, yes. And the reason I say that is because the Eighth Circuit decision in August '98 affirmed the FCC's jurisdiction and authority under the Telecom Act to treat this -- to say the traffic is interstate but the traffic is treated as local and is bought out of local business tariffs. That was affirmed and so that is the state of the law. So I guess the answer is yes.

Now, I'm not agreeing that every single federal agency has the right to grant -- I mean, obviously I wouldn't make such a broad statement. But this is the issue at hand.

Q Let me ask you this. If, in fact, it is determined that the FCC as a government agency does not have the authority to grant jurisdiction to a state agency or other federal agency, would you agree in that case that the

Florida Public Service Commission does not have the authority to enter or develop an interim intercarrier compensation plan?

A Well, you said is found not to have jurisdiction. That is the FCC, so I guess it depends on who finds. But I think what you are getting at is that if the FCC's sort of on one hand, on the other hand, type of regulation of ISP traffic is found to be unlawful by a court and therefore struck down. And I frankly think that is unlikely because it was recently upheld by the Eighth Circuit. But if it is struck down, no, it doesn't exist anymore. Yes, that is true.

Q I think I got the answer I was looking for in there. But you then agree that if the FCC is determined not to have the ability to transfer its jurisdiction, if it is determined that by some court, then the Florida Public Service Commission would not have the authority to do what you are asking them to do?

A I'm not sure I would concede that far. I know that if the scenario you described, if there is a final order from a court ruling on the FCC's giving jurisdiction to the states, so to speak, then that theory wouldn't be applicable. But I don't know whether that means that this state would not have another basis for its jurisdiction to make the same decision.

Since there is no such court case right now, we have not presented those arguments when we were trying to justify our position in this case. But there probably are other bases. And, in addition to that, in the FCC's notice of proposed rulemaking that was attached to a part of the declaratory ruling in February, they considered for the future the alternative, that the FCC would determine the intercarrier compensation mechanism.

And it was clear from that discussion that there would be compensation, whether it is the FCC that ends up doing it or the states. So I think it is really inevitable for BellSouth that there will be compensation. I think it is just a question of how long they can put it off.

Q I think we kind of lost the question somewhere.

A Well, I tried to understand the question as best I could.

Q Let me ask you this. I'm sorry, I lost my thought there. The percentage of total access lines company-wide for ICG, what percentage of those serve ISPs?

A Approximately, nationwide 50 percent.

Q So 50 percent of your access lines are dedicated to serving ISPs nationwide, approximately?

A Right. Yes, that's what I said.

Q How about for the total revenues of ICG, what percentage of those are derived from providing service to

ISPs, including reciprocal compensation?

A I feel somewhat uncomfortable discussing details about my company's revenue that we are not required to report publicly by the Securities and Exchange Commission. Suffice it to say that it is in the ballpark of -- well, we don't -- the revenues from reciprocal compensation from BellSouth, for example, since we haven't been paid, it is hard to know how to account for those. But it is generally, you know, probably close to the split of the traffic at this point in time.

Q So excluding the reciprocal -- let me ask you this. Have any other RBHCs paid ICG for reciprocal compensation?

A Yes.

Q Which RBHCs are those?

A Ameritech for Ohio, Southwestern Bell for Texas, and many other RBHCs have paid, we just happen not to compete in their region. Bell Atlantic has paid for many of its states, perhaps all.

Q At the moment I'm limiting it strictly to ICG, paying ICG.

A We have been paid by Ameritech. We have been paid by Southwestern Bell for Texas.

Q Of your total reciprocal compensation billing, how much of it has been paid percentage-wise?

MR. KRAMER: I'm going to object here. That is not public information.

COMMISSIONER DEASON: I'm sorry. That's what?

MR. KRAMER: That is not public information.

COMMISSIONER DEASON: There has been an objection made.

MR. EDENFIELD: I don't know if it's public or not. It is certainly relevant to the issues here in the case. I mean, if they are trying to assert some type of trade secret or other privilege, so be it, but I think it is definitely relevant. And absent some type of privilege, I think she should be required to answer the question, respectfully.

COMMISSIONER DEASON: Mr. Fordham.

MR. FORDHAM: Where are we?

COMMISSIONER DEASON: We have had a question asked and there has been maybe not a formal objection, but it at least has been noted that it probably would require confidential information to be disclosed. And BellSouth basically says, so be it. So where are we?

MR. FORDHAM: I think I probably agree with ICG, Commissioner, that this may be getting a little more into the personal property or the proprietary interest of the company. Also, I had wondered about the relevance.

COMMISSIONER DEASON: What is the relevancy of this question?

MR. EDENFIELD: The relevance is they are claiming that they need reciprocal compensation to do business in the State of Florida, and absent they cannot come in and do business in the State of Florida. So certainly how dependant they are upon ISPs for their income and whether they intend to come here and serve residential customers, small business customers, exactly how they plan to come in here and do business is relevant to how the scheme or the compensation plan should be set up.

COMMISSIONER DEASON: Why don't you ask them if they plan to serve other customers and we'll see if that is confidential in their business plan.

BY MR. EDENFIELD:

Q Does ICG plan to serve customers other than ISPs in the State of Florida?

A Yes, we do. And if I could just answer the question as you restated it just a moment ago, whether or not ICG will receive compensation for ISP traffic in this state is not in and of itself going to be determinative for us of whether we operate here. We are sort of in a unique position because in all of the other BellSouth states we have been operating. In this state we are not operating yet. We are poised very shortly to do so. And so if this Commission were to unfortunately find that reciprocal compensation does not apply to ISP traffic, our numbers crunchers, for lack of a better term, would have to go back to the drawing boards and relook at the business plan for Florida.

What we believe is, though, is that consistent with what the Commission ruled earlier in this state, that reciprocal compensation will apply. But the truth is that even where Commissions have required reciprocal compensation of BellSouth, they have continued to refuse to pay. So that we are in the same position essentially in a state like Alabama where we have a rather mature network in Birmingham as we are in this state. But we still continue to operate in Birmingham.

Q I'm sorry. Please excuse me. I did not mean to interrupt you.

A That is okay.

Q Your position is that this does not have an effect -- whether you get -- let me start over. Whether you get reciprocal compensation for ISP traffic has no affect as to whether you are going to do business in the State of Florida, is that what you are saying?

A That's not what I said. I said it is not in and of itself, it is not in and of itself determinative.

Q All right. Well, turn with me if you would to Page 5 of your testimony, starting on Line 22. And that is your direct testimony.
A Yes.
Q Do you not state, "In addition, with reciprocal compensation for calls to ISPs precluded as a source of revenue, ICG would find it necessary to weigh whether it would be a wise business decision to provide service to ISPs and their customers in Florida?"
A Yes, I see that. That is exactly what I just said but using different words.
Q And going further down on Page 6 on Line 13.
A Yes.
Q In the middle of the thing there, without receiving fair compensation for the service it provides its competitors, ICG would be significantly handicapped in the competitive marketplace and would likely reassess its plans for business in this state, is that not what you said?
A Yes, that is consistent with what I just said, that we would go back to the drawing boards with the business plan and numbers crunching. It is very difficult to operate, to predict business-wise how to plan where to compete when even where we are competing are fully effectuated facilities-based ALEC with a PUC effective decision requiring payment for reciprocal compensation. And

we are still not receiving that from BellSouth. So that is a factor, it is an overhanging factor on our revenues and our relative earnings. So it makes it especially difficult to look at a new state where we don't have the capital commitment yet.

Q Would you be required to go back to the drawing board after the FCC releases its order under that same analysis?

A When it releases its final order, the MPRM on reciprocal compensation?

Q If it represents a change from what Florida does?

A Well, I think if the FCC -- when the FCC issues its order, I expect to be in business in this state before the FCC issues its order. Maybe I'm wrong. Maybe they will do it sooner, but we plan by the fourth quarter this year, and I don't know that the FCC plans to have issued a decision by then.

So I think the question -- a better direct answer to your question is probably that, of course, the FCC's ruling will have an effect on our business plans in general. When I indicated that 50 percent of our lines are going to ISPs as customers, of course that will be something that we'll have to consider. But I can't say that it would be solely focused on Florida or determinative for Florida. That's what I don't want to concede, I guess.

Q Okay. Do you agree that your company's objectives as to its targeted businesses are ISP and carrier customers?

A No, absolutely not.

Q Are you familiar with your company's 10K filing from March 30th, 1999?

A Yes, I have read it.

Q Does your company's -- if you are familiar with it, does your company's strategy not say the company's objective is be a premier provider of high quality communication services to its targeted businesses, ISP, and carrier customers?

A But you didn't -- before you said just ISPs and carriers, and it says businesses, business customers.

Q No, it says targeted businesses, ISP and carrier customers. Are not your target businesses ISP and carrier customers according to your own 10K of this year?

A You are misreading it, because 50 percent of our lines are what we call commercial, which are not to ISPs or carriers. They are traditional business services. I think you are misreading that one sentence, but it is throughout the whole thing. I think it is very clear.

COMMISSIONER DEASON: What kind of businesses are those? Are those the pizza delivery services and chat lines you refer to in your testimony?

THE WITNESS: Not solely. I mean, if we look at where we serve other markets, we have many different types of business customers. Medium, large customers, which are, you know -- excuse me. Large business customers, medium-sized business customers, and even relatively small business customers in particular where our fiber network reaches them, of all different kinds of traffic patters we serve, all different kinds of customers.

COMMISSIONER DEASON: Do you screen customers upon what their ratio of incoming versus outgoing calling is?

THE WITNESS: Oh, no, we don't.

COMMISSIONER DEASON: Do you have an idea of which customers have more incoming calls?

THE WITNESS: Well, with respect to -- I think it's obvious with ISPs it is incoming, but with respect to regular, for lack of a better word, business customers, we don't do that screening, and I don't -- we don't consider that information. Of course, we know what traffic transits our network, but that is not a decision in marketing or any other kind of focus.

COMMISSIONER CLARK: Ms. Schonhaut, I take it that that offering or whatever you read from describes three types of customers, businesses, ISP, and carriers. I think he is reading it -- it is businesses, and there are two types of businesses as described as being ISPs and carriers. You are saying it is three categories?

THE WITNESS: Yes.

BY MR. EDENFIELD:

Q For those ISPs served by ICG, over what services are they provided service? In other words, is it PRI, ISDN, primary rate ISDN? Is that the primary vehicle?

A The primary rate interface ISDN, PRI is the most often the service bought by ISPs.

Q Is the basic primary rate charge that ICG charges to its ISP customers, is it priced below that of BellSouth's basic primary rate ISDN service?

A It is priced below the similar service offered by Bell, yes.

Q And in addition to already offering it at below BellSouth's cost, you also indicate that ICG leads the pack, so to speak, in offering volume and term discounts?

A I'm not sure I used the term leads the pack, but we do offer volume and term discounts to ISPs.

Q I will warrant that you did not use the term leads the pack.

A Right. But, yes, we do offer ISPs volume and term discounts.

Q In fact, the quote is ICG has led the way?

A (Indicating yes.)

Q Okay. And those volume and term discounts you offer, those are discounts off of your price that is already below that of BellSouth's?

A Yes.

Q And how much of a discount are you offering generally to your ISP customers in a range?

A Well, let me start with what the nondiscounted price is, so I can use that as the benchmark. Because obviously Bell is the dominant provider, we must price competitively. And so our prices are lower than Bell's prices. Generally not by very much. It could be a small increment as low as 5 percent lower, but when you are talking about a customer with high volume telecommunications needs, which, of course, ISPs are, that 5 percent becomes significant.

As the customers' demands increase, or if it is a much larger customer, then we would be able to offer volume and term discounts to reflect our cost savings from having such a large volume scale -- economies of scale and scope, and also the term commitment to the revenue. So it might be an additional discount, it may be up to the maximum. I'm not sure this is the exact number, of 15 -- an additional 15 percent lower than the Bell price for a long-term large commitment.

Q All right. I'm not sure I got really what I was looking for in there, but just help me out a little bit. What is the range of discounts you offer off of your basic primary rate ISDN?

A Well, I'm going to give you a general range, because in some states our prices are not regulated as such, and so they are competitively sensitive. But I think I can tell you that as a customer's volume and term increases, they could get a per unit discount, which would be per circuit, per PRI circuit, of perhaps as high as 20 or maybe even as high as depending on 25 percent less per unit than the price would be if they bought a single unit for a shorter term.

Q Thank you. That's more what I was looking for, thank you. ICG has costs which it incurs in providing service through the primary rate ISDN service to its ISP customers, I assume?

A Yes.

Q Does ICG cover its costs in the rate it charges as its basic primary rate ISDN service?

A I'm having difficulty answering that question because the term cost is such a loaded word and there are so many different versions of it.

Q This isn't a Bill Clinton, what do you mean by cost, is it?

A I'm not meaning to be coy, it's just that we have TSLRIC, TELRIC, embedded, you know, there are many different kinds of costs. A company like ICG does not do cost studies and certainly doesn't do TSLRIC or TELRIC type cost studies where we are able to determine our specific costs for specific circuits on a service or element basis.

But one thing I can tell you is that we are a competitive business. We don't have any monopoly services to cross-subsidize from, so we have to cover our costs and make money in our investors' definition of long-term.

Q Is ICG a profitable company?

A Well, we don't have -- no, we are not a profitable company. The reason I hesitated is because we recently reached a benchmark of having positive earnings, but that doesn't mean we are making a profit.

Q Do you remember when we discussed this in North Carolina, this very topic, about covering the cost? And by cost I mean expenses associated.

A Yes.

Q Let me ask you one more time. Does ICG cover the expenses it incurs at the rate it charges, its basic primary rate ISDN charge, does it cover the expenses associated with providing the service to the ISP customer?

A Okay. I will answer that question, even though you are not really defining what you mean by costs or expenses. But I think what I would say to that is what we derive -- the costs that are recovered through the rate that we charge the ISP for the service that we provide to them is for the service we provide to them. That is for the dial tone and for the connection to the network at particular speeds, such as PRI. They do not -- those prices that we have do not recover the costs of taking traffic from a BellSouth customer or taking traffic from many BellSouth customers and bringing them to our ISP customer for termination or for delivery to the modem bank or the dial tone facility and connection to the network. Those costs are not recovered in those rates.

Q Do you cover your expenses or not?

MR. KRAMER: I'm sorry, was there a question? What did you say?

Q Maybe I'm just not understanding, and I don't mean to be obtuse, or I don't mean to be cute. I really do not feel like I got an answer to the question. If you did answer it, I apologize. All I'm really trying to figure out is a yes or no, does ICG, the rate that it charges for primary rate ISDN service to its ISP customers, does that rate cover the cost or expenses that ICG incurs in providing that service to the ISP? If you answered it, I am terribly sorry and I apologize to you. But it is really a yes or no.

A I did answer that, but I defined everything along the way because these are loaded terms of art. But with those definitions I said yes. But I also identified what by definition, at least in my definition is not included, is not recovered.

Q Okay. Do you know what costs ICG incurs in providing primary rate ISDN service to its ISP customers?

A I don't have that personal knowledge.

Q If you are not sure what the costs are, how are you sure whether you are covering them?

A Because there are other people in my company who -- we do our own business plan as a determination of what price you would need to sell something at and what kinds of services to provide. And that is their responsibility, to make sure that we recover our costs. Including, you know, just as normal business would. I mean, you are not going to go into business and sell something that you are going to put yourself out of business. I mean, I'm not trying to be coy. It seems very common sense to me.

MR. KRAMER: Mr. Edenfield, maybe I could just help by asking, does the revenue ICG receives from its ISP customers make contributions --

COMMISSIONER DEASON: Excuse me. There will be opportunity for redirect.

MR. KRAMER: I was just trying to shorten it.
Thank you.

BY MR. EDENFIELD:

Q Have you had a chance to read the South Carolina recent decision on Deltacom, the arbitration?

A No, I have not. I haven't read it. I tried to get it off the South Carolina Commission's web site last night and it wasn't available.

Q I don't want to ask you questions if you are not familiar with it. I don't think that is fair.

A Okay.

Q Do you recall when we were in North Carolina that I asked you the following question, and I'm citing from the transcript at Page 60, Line 11. I'm sorry, at Line 8.

"Let's sort of make it even more clear, what costs, and you delineate what they are, does ICG incur when it provides service to an ISP in North Carolina? And your answer was, well, ICG obviously incurs costs when we provide services, but because we are not required to do so, we do not break that out by service or by state.

"So, for example, a company like ICG that operates in a lessened regulatory environment for this type of service which we are not required to tariff, for example, in North Carolina, we do not and we do not develop a bottom of cost basis for our rates, but what I can tell you is that we are not a profitable company yet, so that if you -- I really had to answer whether we cover our costs. I might have to say no."

Do you recall that question and answer from North Carolina?

A Yes, I think that is probably what I said. You are obviously misconstruing it and taking it out of context, but I will agree the transcript is probably accurate.

Q Is it your position that the role of the Florida Public Service Commission is to make a policy decision in this case that will have a fundamental impact on the development of the Internet in this state?

A Oh, yes, I have said that.

Q Do you think that is the role of the Commission?

A Well, it is one of the Commission's roles, but it is one that comes up because of the issues in this case.

Q Do you think it is a higher role of the Commission to ensure that competition flourishes in all aspects of the State of Florida? Do you think that is a higher role than development of the Internet?

A Well, let me -- if I may just explain what I mean by this Commission's role in the development of the Internet.

Q If you would just answer my question yes or no first and you then can explain whatever you like.

A I don't know. That is the answer. I don't know what this Commission's priorities of goals are.

Q Or what they should be? Do you have an opinion?

A I would have to take time to think about it and I would study the statute and study the Commission's cases and I certainly wouldn't give that off the top of my head. But I think what is missing in the question is that the Commission's role with respect to the development of the Internet and the urgent priority I think that is presented by this case really isn't related to the Internet as we -- you know, the worldwide web. It is related to the telecommunication services that are needed to provide access to the Internet, and that is part of this Commission's goal, and that definitely overlaps if not is totally overlapping with the goal of promoting competition.

Because Internet access is the largest growing service, and if BellSouth accomplishes its goals in this case, then you will see very little if no competition in providing Internet access in this state. And the Internet access is a telecommunications service. So I think that the goals overlap, actually.

Q Are you familiar with the LERG?

A Yes.

Q Do you know whether any of ICG's switches are identified in the LERG as providing a tandem functionality?

COMMISSIONER CLARK: Could you remind us what a LERG is?

Q Ms. Schonhaut, what is a LERG?

A Local Exchange Rooting Guide.

Q And what is that exactly?

A Well, it is essentially a database of routing tables so that dialed numbers can be sent to the right place, I think. And it has to be consistent and everybody registers switches in there so that traffic will go to the right place. And the answer to your question is yes, every one of ICG's switches is registered in the LERG as a tandem.

Q They are registered as providing tandem functionality for local traffic?

A They are registered in the LERG as a tandem.

MR. EDENFIELD: Thank you, Ms. Schonhaut.

COMMISSIONER DEASON: Staff.

MR. FORDHAM: Just a couple of questions. Thank you, Commissioner.

CROSS EXAMINATION

BY MR. FORDHAM:

Q In your rebuttal testimony you stated that the enhanced extended link is a UNE combination that does currently exist in BellSouth's network, is that correct?

A Yes.

Q You know that to be a fact?

A Well, I believe that to be true.

Q If ICG were to physically collocate in a BellSouth central office to obtain the functionality of the enhanced extended link, would ICG have to combine the unbundled loop and the interoffice transport?

A Would we have to do the combining, is that your question?

Q Yes.

A We wouldn't necessarily have to, but we could. What I do know is that not only in addition to existing traditional services that are bought by customers that connect the loop to the ports, to the transport, I also know that BellSouth is offering enhanced extended loops to another ALEC in this region. So the combination definitely exists. In that case, Bell does the combining.

MR. FORDHAM: Thank you. No further questions.

COMMISSIONER DEASON: Commissioners. I have a question, kind of a general one. Do you think a LEC should be indifferent as to whether an existing customer or a prospective customer has more or less incoming versus outgoing calling traffic?

THE WITNESS: I think that in the current environment, which is the transitional introductory competition that we live with, it is a different analysis than it was before. In a monopoly market, obviously all of the calls that go in go out, and it ends up over time being even.

But as you start to introduce competition, people start to -- that is customers look for new providers because they are not satisfied with the Bell company or they have needs that are not met by the Bell company, the prices they don't like from the Bell company, or both. And those customers are obviously going to be intensive telecommunications users, whether they are outbound or inbound.

And the way businesses are today, a lot of customers have sort of equal amounts, but depending on what they produce or what they sell, they might be heavy in-bound or heavy out-bound. But a lot of their expenses are paid to telecommunications companies. They are the ones that either come to us or that are easier for us to sell to, obviously, than customers with low bills who it is not a priority for them.

COMMISSIONER DEASON: I understand that apparently customers that are attracted to you or customers which you seek are usually the customers with the higher bills. Still, my question is should a LEC, and I don't care if it is an incumbent LEC or a competitive LEC, should the LEC be indifferent of the proportion of an existing or prospective customer of that proportion of incoming versus outgoing traffic?

THE WITNESS: I think yes.

COMMISSIONER DEASON: Well, then why is 50 percent of your customers ISPs?

THE WITNESS: And I apologize, because I think I was giving that answer to the previous question. The reason they are -- it is such a large proportion is for several reasons. One is that the ISPs are obviously intense telecommunications users, they don't exist without telecommunications. They are a hot new growing market with significant growth curves.

Bell is unable or unwilling to meet a variety of their needs, and the ISPs in many cases come to us and they say we are going have this huge growth, and we are going to be in these places, and we are going to have intense demands, and we also want a cheaper price than Bell. And that is what we are able to produce.

For other customers, the sort of other category of customers, it is a different type of marketing environment. And I think that one of the reasons we are -- not only are we price competitive and we are able to provide the demand at this very steep growth curve, but we are also able to provide innovative services that Bell is unwilling to provide.

For example, we will collocate ISPs in our central offices, so to speak, in our nodes. Bell refuses to do that. That is something that the ISPs want. So obviously they would flock to us.

COMMISSIONER DEASON: Does reciprocal compensation give an incentive to CLECs to seek ISPs as customers?

THE WITNESS: I don't think that that is true. I think that what happened first is that the ISPs came to us with these really intense demands, and the amount of minutes and the growth curve is absolutely staggering. We incurred costs that we wanted to recover and -- but now that we are not getting paid, we are not even recovering those costs and we are in a dilemma. But I think what came first is the market demand.

COMMISSIONER DEASON: Redirect.

MR. KRAMER: Thank you.

REDIRECT EXAMINATION

BY MR. KRAMER:

Q Ms. Schonhaut, does the revenue that ICG receives from its ISP customers for providing service to them make a contribution -- sufficient to make a contribution to joint and common costs?

A Yes, it makes some contribution.

Q Mr. Fordham asked you about whether EEL is a combination in the network, do you recall that?

A Yes.

Q And you stated it is an existing combination?

A Yes.

Q Did you have in mind a particular service that is just a combination of loop and transport with a cross connect between them?

A Well, I mean, a local private line service would be something -- it looks just like that, and that is one example of that kind of connection.

Q If ICG is given -- what is ICG's primary purpose in seeking EELs?

A Our purpose in seeking EELs is to provide local exchange service to customers served by central offices where we are not yet collocated. Well, as I said earlier, we were going to kick off service, we are planning to in Florida and Miami. The first thing we do is we leased and prepped, prepared, a site for our switch.

Now the next thing is to install the switch, then we will move to collocate with Bell and buy and install the trunks between the collocation and our switch. Obviously we won't be able to collocate in many central offices for quite some time. If we were able to purchase EELs to serve customers out of those central offices, we could take their traffic to our switch and offer them a competitive alternative.

Q Do you know if ICG direct trunks to interexchange carriers or if it switches its long distance traffic through the LEC tandem?

A I'm sorry, I couldn't follow the question.

Q Do you know if ICG direct trunks between its end office and IXC POPs, or if it sends its long distance traffic through the LEC tandem?

A Well, for the most part we don't send it through the LEC tandem.

Q You don't?

A The traffic --

Q Long distance traffic?

A Well, we have a network and we are providing service to the customers on our network, and we also serve the IXC's POP. We would take it directly on our network. We wouldn't transverse the Bell network at all. That's why I don't think I'm understanding your example.

Q Ms. Schonhaut, do you remember you had a series of questions from Mr. Edenfield about a series of hypothetical situations?

A Yes.

Q Regarding what if the court did this, and what if the court did that?

A Yes.

Q Is it your view that this Commission should act based on what a court might say about the FCC's jurisdiction at some point in the future, or do you think the state can and should act now?

A I'm certain that the state can, and I believe it should act now. The FCC's order was not stayed, even though it is on multiple appeal, actually appeals from both sides of the issue, and clearly raises controversial issues that actually I believe have been briefed, but oral argument hasn't happened yet, or briefing is going on now. But the order is in effect, and it exists, and until it is changed -- unless and until it is changed, it is the state of the law with respect to this issue.

MR. KRAMER: I believe that's all we have.

COMMISSIONER DEASON: Okay.

MR. EDENFIELD: Commission Deason, I'm not sure of the proper procedure for this, and I apologize. If I would like to try to get in the 10K as a cross examination exhibit, should I move for that now? Would that be your pleasure, or try to do that at the beginning of my case or the close of my case?

COMMISSIONER DEASON: Well, first of all, did you provide a copy of that?

MR. EDENFIELD: I have not. This is something that we came up with last night off the Internet.

COMMISSIONER DEASON: Uh-huh. I will give you the opportunity to make copies of it. We will go ahead and identify it. Could you tell me what it is so I can identify it appropriately for the record?

MR. EDENFIELD: What this is is an ICG Communications, Inc. form 10K, filing date of 3/30/99. It was taken from the Internet at the ICG's -- actually, I'm sorry, it came off of the Free Edgar Com, Inc. website, which has 10Ks for various companies.

COMMISSIONER DEASON: All right. That document which you just identified will be identified as Exhibit Number 4. I would request that you make sufficient copies of that, provide it to all of the parties, and then at a later time I will allow you to make a motion to move it into the record.

MR. EDENFIELD: Thank you, Commissioner Deason.

COMMISSIONER JACOBS: I have one brief question for the witness, I'm sorry.

THE WITNESS: Yes, sir.

COMMISSIONER JACOBS: You have a copy of the FCC's order, right?

THE WITNESS: Yes.

COMMISSIONER JACOBS: Go with me to Paragraph 25.

THE WITNESS: Yes, I have that.

COMMISSIONER JACOBS: Okay. This paragraph generally deals with how commissions might address the context of compensation for ISP-bound traffic in the absence of an agreement by the parties?

THE WITNESS: Yes, that's correct.

COMMISSIONER JACOBS: What is your interpretation of that, of this paragraph, specifically of the last sentence?

THE WITNESS: Well, I think the last sentence and the couple that precede it are really the basis for our claim and our petition for arbitration with respect to this issue. That is that even though the FCC found this traffic to be interstate, that it is still within the purview of this Commission in an arbitration proceeding, which we have here, to make a decision with respect to compensation.

And the decision that we recommend that you make, that we request that you make, is to apply reciprocal compensation, which the FCC then says would not be inconsistent with federal law and what the Commission, this Commission, could do in an arbitration proceeding. And that is the basis for our petition for arbitration on this issue, and it is also the reason why my answer to Mr. Edenfield's question regarding a generic proceeding was that I think you can and should do it, that is decide this issue in this case.

COMMISSIONER JACOBS: What parameters should we adhere ourselves to in establishing such a mechanism? I don't want to engage in that discussion that we had in the preliminary part, but there certainly are some restrictions, you would agree, wouldn't you, on what we can do in doing so? What do you see those restrictions to be?

THE WITNESS: Well, I think that perhaps basic common carrier law, principles of law. There have been some basic principles in telecommunications that have remained unchanged. For example, the cost causation principle. The person or the entity that causes the costs should pay for them, and the person or entity that incurs the cost should be paid. I mean, that is a basic principle.

I also believe that obviously the Commission has its statutory and its policy goals with respect to local competition, and I think would want additional competitors to come to the state. I think those are guiding principles.

COMMISSIONER JACOBS: Thank you. Mr. Chairman, because I did come in after the parties, I would request if they have other questions, that they be allowed to ask them.

COMMISSIONER DEASON: Any further redirect?

MR. KRAMER: Based on Commission Jacob's question?

COMMISSIONER DEASON: Yes.

MR. KRAMER: No.

COMMISSIONER DEASON: Very well. You may be temporarily excused, and we will take a 15 minute recess. Let me ask -- when we reconvene, I will probably ask the question where we stand time-wise and make an assessment of whether we can conclude this evening or whether we need to reconvene tomorrow. So be prepared to answer that question.

(Off the record briefly.)

COMMISSIONER DEASON: I will call the hearing back to order. Before Mr. Varner takes the stand, we need to make an assessment as to where we are time-wise, whether we need to work late this evening or whether we need to come back tomorrow. And BellSouth --

MR. KITCHINGS: I think we will be able to finish tonight. What the parties have agreed to, and Mr. Kramer, please correct me if I mistake this, we are going to have Mr. Varner get up and do direct and rebuttal at the same time. He will be cross examined on both his direct and rebuttal. We will then stipulate in the rebuttal testimony of Mr. Starkey and Ms. Schonhaut, and will not ask any questions on that, so we should be done when we are done with Mr. Varner.

MR. KRAMER: And since Mr. Varner has promised five word sentence direct answers to every question, we are --

COMMISSIONER DEASON: I will believe that when I see it.

MR. KITCHINGS: He must have done that under duress.

COMMISSIONER DEASON: Okay. That sounds good. We will proceed with that understanding and anticipation.

MR. KITCHINGS: Thank you, Commissioner Deason.

COMMISSIONER DEASON: Thank you. You may call your witness.

MR. KITCHINGS: Before Mr. Varner begins, Commissioner Deason, BellSouth would offer a revised version of his testimony as a late-filed exhibit wherein we would strike through all the testimony that has been struck and/or withdrawn by settlement of the parties.

COMMISSIONER DEASON: Very well. Are you going to be providing that at a later time?

MR. KITCHINGS: Yes, sir. It was not available today.

COMMISSIONER DEASON: Very well.

MR. KITCHINGS: That would be without waiving any sort of rights we had on appeal to the ruling on the motion to strike.

COMMISSIONER DEASON: Very well.

MR. KITCHINGS: Thank you. May I proceed?

COMMISSIONER DEASON: Yes, please.

Thereupon,

ALPHONSO VARNER

was called as a witness, and having first been duly sworn, was examined and testified as follows:

DIRECT EXAMINATION

BY MR. KITCHINGS:

Q Mr. Varner, have you been sworn?

A Yes, I have.

Q Would you please state your name and business address?

A My name is Alphonso Varner. My business address is 675 West Peachtree Street, Atlanta, Georgia.

Q By whom are you employed?

A BellSouth Telecommunications.

Q In what capacity are you employed?

A Senior Director for Regulatory.

Q Are you the same Al Varner who caused to be prefiled some 54 pages of direct testimony with eight exhibits?

A Yes.

Q And as well as the direct testimony, Mr. Varner, you have prefiled 17 pages of rebuttal testimony with one exhibit, is that correct?

A That is correct.

Q Do you have any additions, deletions, or corrections to your testimony?

A Yes. With respect to the exhibits on the direct testimony, there was a series of diagrams that were filed, but somehow some of the labeling inside the boxes on the diagrams didn't print for whatever reason.

MR. McGLOTHLIN: And, Commissioner Deason, with your permission, we would pass out corrected diagrams for everyone's benefit at this point in time.

COMMISSIONER DEASON: Please do so.

BY MR. McGLOTHLIN:

Q Are there any other corrections to your testimony, Mr. Varner?

A No, there are not.

Q If I were to ask you the same questions today that appear in your testimony, would your answers be the same with the noted corrections on the exhibits?

A Yes.

MR. KITCHINGS: Commissioner Deason, at this point in time I would move the direct and rebuttal testimony of Mr. Varner into the record, and would ask that the exhibits to Mr. Varner's testimony be marked for identification.

COMMISSIONER DEASON: The prefiled direct and rebuttal testimony of Mr. Varner will be inserted into the record without objection. And that is understood that is the version that we have discussed earlier with the deletions and with that portion that was deleted as a result of the motion to strike?

MR. KITCHINGS: Yes, Your Honor.

COMMISSIONER DEASON: Very well.

COMMISSIONER DEASON: Now, for the exhibits -- excuse me. Are there exhibits attached to the rebuttal?

MR. KITCHINGS: I believe there is one.

COMMISSIONER DEASON: There is one to the rebuttal? Okay. Now we have -- the exhibits that are attached to the direct, those are AJV-1 through 6, correct, or is it 1 through 7? 1 through 6?

MR. KITCHINGS: I have 1 through 8.

COMMISSIONER DEASON: 1 through 8?

MR. KITCHINGS: Yes, sir.

COMMISSIONER DEASON: Now, I have previously determined, I believe, that 6 --

MR. KITCHINGS: 6 was removed.

COMMISSIONER DEASON: What about 7? It appears to me that it may be directly related to the subject matter that was deleted, but I'm wanting input on that.

MR. KITCHINGS: You are correct. It should be removed as well, given the bench's ruling.

COMMISSIONER DEASON: And what about 8, what is that? That is not part of the proposal that was deleted?

MR. KITCHINGS: That is correct.

COMMISSIONER DEASON: Okay. So what we will do is we will identify as Composite Exhibit 5 prefiled Exhibits AJV-1 through 5, and AJV-8. And then the prefiled exhibit to the rebuttal will be identified as Exhibit 6.

MR. KITCHINGS: Thank you.

(Composite Exhibit Number 5 and Exhibit Number 6 marked for identification.)

BELLSOUTH TELECOMMUNICATIONS, INC.

DIRECT TESTIMONY OF ALPHONSO J. VARNER

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 990691-TP

AUGUST 2, 1999

Q. PLEASE STATE YOUR NAME, YOUR POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC. ("BELLSOUTH") AND YOUR BUSINESS ADDRESS.

A. My name is Alphonso J. Varner. I am employed by BellSouth as Senior Director for State Regulatory for the nine-state BellSouth region. My business address is 675 West Peachtree Street, Atlanta, Georgia 30375.

Q. PLEASE GIVE A BRIEF DESCRIPTION OF YOUR BACKGROUND AND EXPERIENCE.

A. I graduated from Florida State University in 1972 with a Bachelor of Engineering Science degree in systems design engineering. I immediately joined Southern Bell in the division of revenues organization with the responsibility for preparation of all Florida investment separations studies for division of revenues and for reviewing interstate settlements.

Subsequently, I accepted an assignment in the rates and tariffs organization with responsibilities for administering selected rates and tariffs including preparation of tariff filings. In January 1994, I was appointed Senior Director of Pricing for the nine-state region. I was named Senior Director for Regulatory Policy and Planning in August 1994, and I accepted my current position as Senior Director of Regulatory in April 1997.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony provides BellSouth's policy position on numerous issues raised by ICG Telecom Group, Inc. ("ICG") in its Petition for Arbitration filed with the Florida Public Service Commission ("Commission") on May 27, 1999. Specifically, I respond to the following issues raised by ICG: 1-11 and 19-26. I will also address the ramifications of recent court decisions as they specifically relate to ICG Issues 1, 3, 4, 6, 7 and 8.

Q. PLEASE SUMMARIZE HOW THE RECENT COURT DECISIONS APPEAR TO AFFECT THIS PROCEEDING.

A. On June 10, 1999, the United States Court of Appeals for the Eighth Circuit ("Eighth Circuit") issued an order in the *Iowa Utilities Board, et al.* case reinstating many of the previously vacated Federal Communications Commission's ("FCC") Rules. These Rules were originally issued in the FCC's First Report and Order and Second Report and Order dated August 8, 1996 in CC Docket 96-98. In light of the Eighth Circuit's recent and past decisions, along with the January 25, 1999 decision by the United States

Supreme Court, the status of the FCC's rules can be divided into several categories as follows.

Even though the FCC's pricing Rules 51.501-51.515 (Pricing of Elements) and 51.701-51.717 (Reciprocal Compensation for Transport and Termination of Local Telecommunications Traffic) have been reinstated, they must still be reevaluated by the Eighth Circuit to consider the various challenges raised to these rules on their merits since the Eighth Circuit's earlier ruling was based solely upon jurisdictional arguments. While these rules are in effect as the Eighth Circuit revisits them, the final pricing rules will not likely be known until the Eighth Circuit acts, which could be several months in the future. In the interim, BellSouth is proposing prices that are consistent with the FCC's pricing methodology and with this Commission's decisions in its generic UNE proceeding. BellSouth also proposes that those prices be modified prospectively when the final rules are known.

The FCC's Unbundled Network Element ("UNE") Rule 51.319 (Specific unbundling requirements) has been vacated and is being readdressed by the FCC. Until that time, which will probably be several months, there is no minimum list of UNEs that BellSouth is required to offer. There are numerous capabilities that competitive local exchange carriers ("CLECs") have requested from BellSouth. As an interim measure, BellSouth is proposing to provide those capabilities although, technically, they are not UNEs, until the FCC's new rules become final. Because the required list of UNEs is unknown, it would not be appropriate to require application of FCC rules that apply to

UNEs to these capabilities during this interim period. When the FCC rules become finalized, BellSouth should be permitted to modify the list of capabilities that it will offer in the interim to conform to the FCC's rules.

Even though the FCC's Rule 51.315(b) (Pre-existing combinations) has been reinstated by the Eighth Circuit, it cannot be effectively applied until the FCC reestablishes the UNE list that was vacated by FCC Rule 51.319. The minimum list of UNEs and criteria for establishing UNEs will not be known until the FCC completes its proceeding on remand. Consequently, the UNEs that must remain combined cannot be known until the FCC completes its review of Rule 51.319.

Finally, the FCC's Rules 51.315(c) through 51.315(f) (ILEC combination of UNEs) continue to be vacated. The Eighth Circuit, however, is seeking comments on whether it should take further action with respect to these rules. Since these rules are not in effect, any action by this Commission requiring BellSouth to combine network elements would be in direct conflict with the Telecommunications Act of 1996 ("Act").

After the FCC and the Eighth Circuit take further action in response to the Supreme Court's decision, BellSouth's position on the issues raised in this proceeding may be affected. As a result, BellSouth may need to modify some of its positions in the months to come.

Q. WHAT IMPACT DOES THE EIGHTH CIRCUIT'S RULING HAVE ON NETWORK ELEMENT COMBINATIONS?

A. With respect to network element combinations, the Supreme Court's vacating of the FCC's Rule 51.319 and its reinstatement of other rules directly impacts the network elements BellSouth is required to provide. In accordance with the FCC's Rule 51.315(a), BellSouth is obligated to provide unbundled network elements in a manner that allows requesting telecommunications carriers to combine them in order to provide a telecommunications service. Though requesting telecommunications carriers may combine unbundled elements in any manner they choose, BellSouth is not required to combine unbundled elements for those carriers. The Eighth Circuit vacated the FCC's rules that purported to impose such a requirement (§§ 51.315(c)-(f)). The Eighth Circuit's decision vacating these rules was not challenged by any party, and because those rules are not in effect, BellSouth is not required to combine network elements. However, BellSouth is willing to perform this function upon execution of a commercial agreement that is not subject to the requirements of the Act.

Q. WHAT IS BELLSOUTH'S POSITION WITH REGARD TO COMBINATIONS OF ELEMENTS THAT ALREADY EXIST IN BELLSOUTH'S NETWORK?

A. Regarding the provision of combinations that already exist in the network, there are no requirements that the Commission can implement until the FCC establishes a list of UNEs, and the associated pricing rules, that incumbent local exchange carriers ("ILECs") must offer. As discussed previously, it is impossible to determine which unbundled network elements BellSouth is required to offer until the FCC reissues its UNE rules in accordance with the Supreme Court decision. Consequently, the UNEs that must remain combined cannot be determined at this time. Likewise, the pricing rules applicable to such combinations will not be known until the Eighth Circuit completes its evaluation. Therefore, with regard to this issue, a final determination of which UNEs must remain connected and functional, as well as the prices for those combinations, will depend upon the outcome of further proceedings before the FCC and the Courts.

The Supreme Court specifically recognized the linkage between Rule 51.315(b) and the list of UNEs. In its discussion of the legality of Rule 51.315(b), the Court stated: "As was the case for the all-elements rule, our remand of Rule 319 may render the incumbents' concern on this score academic." (Sup. Ct. order, at pg. 26). This linkage should not be ignored by requiring provision of services which are allegedly pre-existing combinations of UNEs before the UNEs are defined.

BellSouth is cooperating during this interim period by making numerous capabilities available to CLECs. To penalize BellSouth for its cooperative efforts by invoking a combination requirement at this time would not be reasonable. For the reasons outlined above, BellSouth proposes that all requests for combinations be negotiated between the parties until the FCC's final and nonappealable pricing and UNE rules require different treatment. Should the Commission decline to adopt BellSouth's proposal on the provision of combinations while the final rules are still uncertain, the Commission should allow BellSouth to assess combination charges in order to avoid arbitrage of the tariffed service rates with UNE rates. Such charges are permissible under the Act and are necessary to retain sound pricing.

Q. PLEASE FURTHER DESCRIBE WHY THE COMMISSION SHOULD WAIT ON ACTION BY THE FCC BEFORE SPECIFYING WHICH UNE COMBINATIONS MUST BE OFFERED.

A. The impact of the Supreme Court's decision is such that, for the moment, no one knows for certain exactly *what* network elements must be made available to competing carriers. Even though the Eighth Circuit has simply reinstated the FCC's Rule 51.315(b) prohibiting ILECs from separating already-combined network elements before leasing them to competitors, that rule has no meaning without a determination of what elements meet the "necessary" and "impair" standards under the Act. The Supreme Court's vacating of FCC Rule 51.319 was based on the FCC's failure to apply those standards in deciding which UNEs were required. In short, there is no reasonable way for this Commission to mandate combinations of network elements unless and until it is clear what those elements are.

Q. BRIEFLY DESCRIBE HOW THE SUPREME COURT ADDRESSED THE FCC'S RULE 51.319 (SPECIFIC UNBUNDLING REQUIREMENTS).

A. In striking down Rule 51.319 and the FCC's underlying standard, the Supreme Court categorically rejected the FCC's notion of when an incumbent must provide unbundled network elements to CLECs under the FCC's "necessary" and "impair" requirements. In interpreting those statutory terms, the Supreme Court stated that the FCC's definition of an unbundled network element "cannot, consistent with the statute, blind itself to the availability of elements outside the incumbent's network." (Sup. Ct. Order, at pg. 22) The Supreme Court also observed that the "assumption that *any* increase in cost (or decrease in quality) imposed by denial of a network element renders access to that element 'necessary' and causes the failure to provide that element to 'impair' the entrant's ability to furnish its desired services <u>is simply not in accord with the ordinary and fair meaning of those terms</u>." (Id.) (emphasis not in original) In plainer terms, this language means that "elements" that are available from other sources, including elements that competitors can (and often do) provide for themselves, do not have to be provided by ILECs as unbundled network elements under the Act.

Thus, there can be no requirement for BellSouth to provide any combinations of a specific type or in a locality where there are ready alternatives to any of the constituent network elements. This proscription applies even where those alternatives may be somewhat more costly for the CLEC to obtain from another supplier or by providing them for itself. The Supreme Court anticipated precisely this kind of limitation on the availability of access to network elements when it observed that "if Congress had wanted to give blanket access to incumbents' networks on a basis as unrestricted as the scheme the Federal Communications Commission has come up with, it would not have included § 251(d)(2) in the statute at all." (Sup. Ct. Order, at pg. 23) And in reacting to ILECs' concerns that the reinstatement of Rule 315(b) could obliterate the distinction between unbundled network elements and resale, the Supreme Court noted that "our remand of Rule 319 [*i.e.*, requiring application of the "necessary" and "impair" standards] may render the incumbents' concern on this score academic." (Sup. Ct. Order, at pg.26)

Q. WHAT PROCESS IS LIKELY TO BE FOLLOWED TO IMPLEMENT NEW UNE RULES?

A. The FCC is holding further proceedings to determine what network elements must be unbundled, in accordance with the Supreme Court's interpretation of the necessary and impair test. In the interim, it would be inappropriate to assume that the FCC will merely reissue the list of UNEs originally contained in Rule 51.319. Determining what elements are essential will involve FCC proceedings of some complexity. In fact, FCC Chairman William E. Kennard acknowledged as much when he predicted: "We'll have to go back to the drawing board." (New York Times, 1/26/99 at C4.)

This Commission presumably will have, and should have, a role in implementing the "necessary" and "impair" standards. However, this Commission's decisions should, as a practical matter, await the FCC's definition of those standards. Furthermore, even if this Commission eventually is empowered to decide which elements must remain combined, there has been no determination by the FCC as to exactly which elements those are.

Q. IS BELLSOUTH WILLING TO OFFER ANY ELEMENTS OF ITS NETWORK ON AN UNBUNDLED BASIS BEFORE THE FCC READDRESSES RULE 51.319?

A. Yes. BellSouth still has obligations under the Act that BellSouth will continue to meet. BellSouth will continue to offer any individual UNE currently offered until Rule 51.319 is resolved. However, BellSouth will not offer combinations that replicate retail or access services at the sum of the UNE prices. Such action would cannibalize revenue streams for other services. BellSouth does not believe such action was intended by the Act, and BellSouth would certainly not voluntarily provide such combinations at UNE prices. However, as explained earlier, BellSouth is willing to provide combinations upon execution of a commercial agreement that is not subject to the requirements of the Act.

Q. PLEASE EXPLAIN BELLSOUTH'S PROPOSAL FOR SETTING RATES FOR CAPABILITIES IN THIS PROCEEDING.

A. Where ICG is requesting capabilities for which no rates have been established, BellSouth is filing cost studies that are consistent with the Commission-approved methodology in support of the rates it proposes to charge for those capabilities. BellSouth witness Ms. Daonne Caldwell presents and supports those cost studies.

Even though, during this interim period, BellSouth is proposing prices equal to incremental costs in accordance with FCC rules, BellSouth does not agree that prices should be required to be set equal to incremental costs. As I have testified on several occasions, there are a number of reasons why such a pricing rule should <u>not</u> be established. However, during this interim period, the FCC's rules are in effect and, as a result, prices equal to incremental costs are required.

Q. WHAT HAS THIS COMMISSION PREVIOUSLY DECIDED IN REGARD TO UNE PRICING?

A. Rates for numerous UNEs were ordered by the Commission in its December 31, 1996 Order No. PSC-96-1579-FOF-TP ("December 31, 1996 Order") and subsequently in its April 29, 1998 Order No. PSC-98-0604-FOF-TP ("April 29, 1998 Order"). In its December 31, 1996 Order, at page 22, this Commission determined "that the appropriate cost methodology to determine the prices for unbundled elements is an approximation of Total Service Long Run Incremental Cost (TSLRIC)." Further, on page 23, the Commission quoted ¶678 of the FCC Order 96-325 in which the FCC states that "while we are adopting a version of the methodology commonly referred to as the TSLRIC as the basis for pricing interconnection and unbundled elements, we are coining the term 'total element long run incremental cost' (TELRIC) to describe our version of this methodology."

At page 24, the Commission stated that "upon consideration, we do not believe there is a substantial difference between the TSLRIC cost of a network element and the TELRIC cost of a network element." Then, on page 32, the Commission found that "BellSouth's cost studies are appropriate because they approximate TSLRIC cost studies and reflect BellSouth's efficient forward-looking costs." Finally, on page 33, the Commission stated that "we find it appropriate to set permanent rates based on BellSouth's TSLRIC cost studies. The rates cover BellSouth's TSLRIC costs and provide some contribution toward joint and common costs."

Q. ARE BELLSOUTH'S COST STUDIES GENERALLY CONSISTENT WITH THE FCC'S PRICING METHODOLOGY?

A. Yes. FCC Rule 51.505 defines the FCC's cost methodology for UNEs. BellSouth's Total Service Long Run Incremental Cost (TSLRIC) studies used to support prices for capabilities in this proceeding are generally consistent with those methods. Per the FCC's rules, such costs must be developed using an efficient network configuration which uses the existing location of the incumbent LEC's wire centers. Further, the costs should be developed using a forward-looking cost of capital and economic depreciation rates, and a reasonable allocation of forward-looking common costs is appropriate. The forward-looking economic costs may not include embedded costs, retail costs, opportunity costs or revenues to subsidize other services. Although the FCC uses the term Total Element Long Run Incremental Cost (TELRIC) to describe its method, Ms. Caldwell explains how TSLRIC, as adopted by this

Commission, is consistent with the FCC's TELRIC methodology.

In addition to Rule 51.505, there are several other rules that describe the rate structure requirements that the FCC applies to UNEs. With the exception of Rule 51.507(f), BellSouth has proposed prices for these interim capabilities that are consistent with the FCC's rate structure requirements.

Q. WHAT IS BELLSOUTH PROPOSING WITH REGARD TO GEOGRAPHIC DEAVERAGING?

A. FCC Rule 51.507(f) requires that each state commission establish at least three geographic rate zones for UNEs and interconnection that reflect cost differences. On May 7, 1999 the FCC released an order in CC Docket No. 96-98 issuing a stay of Rule 51.507(f). The stay will remain in effect until six months after the FCC issues its order in CC Docket No. 96-45 finalizing and ordering implementation of high-cost universal service support for non-rural local exchange carriers. Therefore, Rule 51.507(f) should not be applied to the unbundled network capabilities that BellSouth would offer at this time.

Issue 4: Should BellSouth be required to provide as a UNE "Enhanced Extended Link" Loops ("EELs")?

Q. WHAT IS BELLSOUTH'S POSITION ON THE PROVISION OF "ENHANCED EXTENDED LINKS"?

A. ICG has requested what it terms as an "enhanced extended link" or a local loop combined with dedicated transport. There is no question that these extended links or extended loops would be a combination of loops and dedicated transport. Such combinations would create opportunities for price arbitrage because they replicate private line and/or special access services. ICG's request for an "enhanced extended link" would require BellSouth to combine the loop and dedicated transport, a function that BellSouth is not required to perform. However, as previously stated, BellSouth is willing to perform this function upon execution of a voluntary commercial agreement that is not subject to the requirements of the Act.

Issue 1 and Issue 8: Until the FCC adopts a rule with prospective application, should dial-up calls to Internet service providers ("ISPs") be treated as if they were local calls for purposes of reciprocal compensation?

Q. WHAT IS BELLSOUTH'S POSITION ON THE APPLICABILITY OF RECIPROCAL COMPENSATION TO ISP-BOUND TRAFFIC?

A. Reciprocal compensation is not applicable to ISP-bound traffic. BellSouth's position is that payment of reciprocal compensation for ISP-bound traffic is inconsistent with the law and is not sound public policy. Further, BellSouth believes that carriers are entitled to be compensated appropriately based on the use of their network to transport and deliver traffic.

Q. IS THERE ANY REASON FOR THIS COMMISSION TO ADDRESS THIS ISSUE AT THIS TIME?

A. No. The FCC's recent Declaratory Ruling, FCC 99-38 in CC Docket Nos. 96-98 and 99-68, released February 26, 1999, ("Declaratory Ruling"), clearly established that the FCC has, will retain, and will exercise jurisdiction over this traffic. As a practical matter, it appears fruitless for state commissions to deal with this issue at this time. Although the FCC appears to give states authority to create an interim compensation arrangement until the FCC establishes rules, the FCC's authority to confer this ability on the states is being challenged in court. Consequently, states could find that they do not have the authority to create even an interim compensation arrangement. Even if the states do have the authority, such authority is valid only until the FCC completes its rulemaking on the subject. Therefore, any effort devoted by this Commission to establishing an interim compensation arrangement for ISP-bound traffic would likely be wasted effort.

Q. SHOULD THE COMMISSION ARBITRATE THIS ISSUE?

A. No. BellSouth recommends this Commission not address this issue. Any arbitration of ISP compensation issues would necessarily be separate from Section 252 arbitration, which is the subject of this proceeding. Since ISP-bound traffic is not subject to reciprocal compensation, there is no basis for including the compensation determination for such traffic as a subject of arbitration under Section 252 of the Act. Although the FCC's Declaratory

Ruling attempts to authorize states to arbitrate the issue of inter-carrier compensation for ISP-bound traffic, the FCC cannot simply expand the scope of Section 252 to cover such arbitrations.

Q. PLEASE EXPLAIN YOUR STATEMENT THAT COMPENSATION FOR TRAFFIC BETWEEN END USERS AND ISPs IS NOT SUBJECT TO ARBITRATION UNDER SECTION 252.

A. Only local traffic is subject to reciprocal compensation obligations. As previously confirmed by the FCC's Declaratory Ruling, ISP-bound traffic is jurisdictionally interstate; therefore, reciprocal compensation for ISP-bound traffic under Section 251 is not applicable. Consequently, compensation for such traffic is not subject to arbitration under Section 252. Further, payment of such compensation is not a requirement under Section 271.

Q. HOW IS THE ISSUE THAT ICG HAS RAISED DIFFERENT FROM THE ISP ISSUES ALREADY ADDRESSED BY THIS COMMISSION IN PREVIOUS PROCEEDINGS?

A. In previous proceedings, this Commission dealt with interpretation of language in <u>existing</u> Interconnection Agreements. The issue at hand today deals with a <u>new</u> Interconnection Agreement; therefore, any previous rulings on language interpretation are irrelevant to this case. BellSouth notes, however, that its position, which was confirmed by the FCC, has always been that calls to ISPs were not local calls; thus, BellSouth never anticipated paying reciprocal compensation on ISP-bound traffic.

Q. HOW DO THE ACT AND THE FCC'S FIRST REPORT AND ORDER IN CC DOCKET 96-98 ADDRESS RECIPROCAL COMPENSATION?

A. Reciprocal compensation applies only when local traffic is terminated on either party's network. One of the Act's basic interconnection rules is contained in 47 U.S.C. § 251(b)(5). That provision requires all local exchange carriers "to establish reciprocal compensation arrangements for the transport and termination of telecommunications." Section 251(b)(5)'s reciprocal compensation duty arises, however, only in the case of local calls. In fact, in its August 1996 Local Interconnection Order (CC Docket No. 96-98), paragraph 1034, the FCC made it perfectly clear that reciprocal compensation rules do not apply to interstate or interLATA traffic such as interexchange traffic:

> *We conclude that Section 251(b)(5), reciprocal compensation obligation, should apply only to traffic that originates and terminates within a local area assigned in the following paragraph. We find that reciprocal compensation provisions of Section 251(b)(5) for transport and termination of traffic do not apply to the transport and termination of interstate or intrastate interexchange traffic.*

This interpretation is consistent with the Act, which establishes a reciprocal compensation mechanism to encourage local competition.

Further, in Paragraph 1037 of that same Order, the FCC stated:

We conclude that section 251(b)(5) obligations apply to all LECs in the same state-defined local exchange areas, including neighboring incumbent LECs that fit within this description.

Therefore, since ISP-bound traffic is not local traffic it is not subject to the reciprocal compensation obligations contained in Section 251 of the Act.

Q. PLEASE DISCUSS THE FCC'S RECENT DECLARATORY RULING.

A. The FCC has once again confirmed that ISP-bound traffic is subject to interstate jurisdiction and is not local traffic. In its Declaratory Ruling, the FCC concluded that "ISP-bound traffic is non-local interstate traffic." (fn 87) The FCC noted in its decision that it traditionally has determined the jurisdiction of calls by the end-to-end nature of the call. In paragraph 12 of this same order, the FCC concluded "that the communications at issue here do not terminate at the ISP's local server, as CLECs and ISPs contend, but continue to the ultimate destination or destinations, specifically at an Internet website that is often located in another state." Further, in paragraph 12 of its Declaratory Ruling, the FCC finds that "[a]s the Commission stated in *BellSouth MemoryCall,* this Commission has jurisdiction over, and regulates charges for, the local network when it is used in conjunction with the origination and termination of interstate calls."

The FCC's decision makes plain that no part of an ISP-bound communication terminates at the facilities of an ISP. Once it is understood that ISP-bound traffic "terminates" only at distant websites, which are almost never in the same exchange as the end-user, it is evident that these calls are not local.

Q. IS BELLSOUTH'S POSITION REGARDING JURISDICTION OF ISP TRAFFIC CONSISTENT WITH THE FCC'S FINDINGS AND ORDERS?

A. Absolutely. BellSouth's position is supported by, and is consistent with, the FCC's findings and Orders which state that for jurisdictional purposes, traffic must be judged by its end-to-end nature, and must not be judged by looking at individual components of a call. Therefore, for purposes of determining jurisdiction for ISP-bound traffic, the originating location and the final termination must be looked at on an end-to-end basis. BellSouth's position is consistent with long-standing FCC precedent.

Q. PLEASE DESCRIBE IN MORE DETAIL THE TRAFFIC THAT IS ELIGIBLE FOR RECIPROCAL COMPENSATION?

A. As I have previously stated, local traffic is eligible for reciprocal compensation. Exhibit AJV-1 to my testimony contains two diagrams. Both of these diagrams illustrate local calls between end users. Diagram A illustrates a typical local call where both ends of the call are handled by a single carrier's network which, in this example, is an ILEC's network. In this scenario, the ILEC receives a monthly fee from its end user to apply towards the cost of that local call. For that payment, the ILEC provides the end user with transport and termination of local calls throughout the local calling area. End users typically do not pay for calls terminated to them. Importantly, in this case, the end user is the ILEC's customer, which means that the end user pays the ILEC revenue for the service.

By comparison, Diagram B illustrates a typical local call that is handled by two carriers - one end of the call is handled by an ILEC, and a CLEC handles the other end of the call. In this scenario, when the ILEC's end user makes a local call to the CLEC's end user, the ILEC's end user is paying the ILEC the same price for local exchange service as in Diagram A. The ILEC, however, is not the provider of the entire network facilities used to transport and deliver the local call. The CLEC is providing part of the facilities and is incurring a cost. Since the end user is an ILEC customer, the CLEC has no one to charge for that cost. As previously noted, end users do not pay for local calls terminated to them, so the CLEC cannot be expected to charge its end user. While the ILEC is receiving the same revenues as shown in Diagram A, its costs are lower. Consequently, reciprocal compensation would be paid by the ILEC to compensate the CLEC for terminating that local call over its network. If the reciprocal compensation rate equals the ILECs cost, the ILEC is indifferent to whether the ILEC or the CLEC completes the call.

Likewise, if a CLEC's end user completes a local call to an ILEC's end user, the CLEC receives the payment for local exchange service from the end user, and the CLEC pays the ILEC reciprocal compensation for the portion of the

ILEC's facilities used to terminate the local call. In accordance with the Act, the purpose of reciprocal compensation is to ensure that each carrier involved in carrying a local call is compensated for its portion of that call. The following table contains a simple illustration of the application of reciprocal compensation.

DIAGRAM A:	ILEC	CLEC
END USER REVENUE	$15	$0
SERVICE COST	($35)	$0
NET MARGIN	($20)	$0
DIAGRAM B:	ILEC	CLEC
END USER REVENUE	$15	$0
RECIPROCAL COMPENSATION	($2)	$2
SERVICE COST	($33)	($2)
NET MARGIN	($20)	$0

Q. ARE ISP's CARRIERS?

A. Yes. The fact that ISPs are carriers and that the service provided to them is access service is very important. This simple fact eliminates any possible claim for reciprocal compensation. The FCC has been very clear in its rulings that reciprocal compensation does not apply on access service.

Treating ISPs as carriers is not a recent creation of the FCC. From its inception over 30 years ago, the FCC has regulated data carriers as interstate carriers. These carriers were allowed to collect traffic at business rates. When access charges were established in the early eighties, the FCC reconfirmed that these carriers, i.e., ESPs, were being provided access service, but ESPs received an exemption from regular access charges and were allowed to continue collecting traffic for the price of business service. Importantly, the FCC was clear that the service being provided was access service, not local service. The business rate was simply the price charged for the access service. This same arrangement was undisturbed by the Act and was recently reconfirmed by the FCC in its Declaratory Ruling.

Q. WHY IS THE FACT THAT ISPs ARE CARRIERS AND ARE PURCHASING ACCESS SERVICE IMPORTANT?

A. The fact that ISPs are carriers is important because carriers must pay the full cost of the service provided to them. When an interexchange carrier ("IXC") or an ISP purchases access service, it is the IXC or the ISP, not the end user, who is the customer of the local exchange carrier ("LEC") for that service. It is the IXC or the ISP who must pay the full cost of the service. Since the IXC or the ISP (and not the end user) pays the full cost of the service, the cost of the local network used to provide access service is appropriately excluded from the cost of universal service. This arrangement is based on the fact that the ISP or IXC is the retail provider of service to the end user. The LEC provides an input (access service) that the ISP or IXC uses to provide its retail service.

Consequently, the ISP or the IXC, not the end user, pays the full cost of the access service provided to them.

Q. YOU STATE, AND THE FCC HAS CONFIRMED, THAT ISP-BOUND TRAFFIC IS JURISDICTIONALLY INTERSTATE. DOES THIS AFFECT THE ISP ACCESS CHARGE EXEMPTION?

A. No. The FCC concluded in its Declaratory Ruling that its determination that ISP-bound traffic is interstate does not alter the current ISP exemption. ISPs continue to be permitted to access the public switched telecommunications network by paying basic business local exchange rates rather than by paying interstate switched access tariff rates. The FCC's decision to exempt ISPs from paying access charges for policy and political reasons in no way alters the fact that ISP-bound traffic is access traffic, not local traffic. If the FCC had indeed concluded that ISP-bound traffic was local, there would be no need for the FCC to exempt that traffic from the access charge regime. Likewise, no decision regarding reciprocal compensation would affect this exemption.

Exhibit AJV-2 attached to my testimony consists of two diagrams. Diagram C illustrates a typical interstate call originating on a LEC's network and delivered to an IXC's Point of Presence. As shown by this illustration, the LEC receives access charges from the IXC as compensation for use of the LEC's facilities to deliver the traffic to the IXC. The IXC bills the end user.

Diagram D is different from Diagram C in only one respect. The IXC has been replaced by an ISP. The network used to transport ISP-bound traffic is exactly the same network used to deliver traffic to IXCs. However, rather than through receipt of normal switched access charges, the LEC is compensated for the access service it provides to the ISP by the business rates it charges the ISP. The important point is that both IXCs and ISPs receive the same service and, although they are charged different prices, the prices they pay are designed to cover the same costs. That cost is the full cost of providing service to them.

Q. WHAT DOES BELLSOUTH CONSIDER TO BE THE APPROPRIATE COMPENSATION MECHANISM FOR ISP-BOUND TRAFFIC?

A. In its Comments and Reply Comments to the FCC's Notice of Proposed Rulemaking in CC Docket No. 99-68, In the Matter of Inter-Carrier Compensation for ISP-Bound Traffic ("Inter-Carrier Compensation NPRM"), BellSouth puts forth its proposal for the appropriate inter-carrier compensation mechanism. (See Exhibit AJV-3) BellSouth's proposal is guided by and is consistent with FCC precedent regarding inter-carrier compensation for jointly provided interstate services. BellSouth's proposal recognizes, as does the FCC, that the revenue source for ISP-bound traffic is derived from the service provided to the ISP. (*See* In the Matter of Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing and End User Common Line Charges, CC Docket Nos. 96-262,94-1, 91-213 and 95-72, *First Report and Order,* 12 FCC Rcd 15982, 16133-16134 (1997)) Equally important, BellSouth's proposal ties the level of inter-carrier compensation directly to the level of compensation that each carrier derives from the jointly provided service.

Exhibit AJV-4 to my testimony consists of two diagrams illustrating the consistency of compensating carriers for access traffic based on the revenue that is derived from the jointly provided service. Diagram E illustrates a call that originates on a LEC's network and is delivered to an IXC/ISP, and shows that the IXC/ISP pays the LEC for access services to cover the cost of getting the traffic to the IXC/ISP. Diagram F illustrates an IXC/ISP-bound call that originates on a LEC's network and interconnects with another carrier's network (ICO/CLEC) for routing of the call to the IXC/ISP. In this situation, the IXC/ISP is the other carrier's customer. The revenue this other carrier receives from the IXC/ISP for access services covers the cost of delivering the traffic to the IXC/ISP.

Q. PLEASE DESCRIBE HOW ICG REQUESTS THAT IT BE COMPENSATED FOR ISP-BOUND TRAFFIC.

A. Exhibit AJV-5 to my testimony consists of a Diagram G which illustrates ICG's request that BellSouth pay reciprocal compensation for ISP-bound traffic where the ISP is ICG's customer. It is obvious from this diagram that ICG is simply attempting to augment the revenues it receives from its ISP customer at the expense of BellSouth's end user customers. In other words, paying ICG reciprocal compensation for ISP-bound traffic would result in BellSouth's end user customers subsidizing ICG's operations. Indeed, the

FCC has recognized that the source of revenue for transporting ISP-bound traffic is the access service charges that ISPs pay. ICG receives this payment from its ISP customers. There is no legal or policy basis for ISPs to be subsidized simply because they choose a different carrier to provide their access service.

Q. WHY IS AN INTER-CARRIER COMPENSATION ARRANGEMENT APPROPRIATE FOR ISP TRAFFIC?

A. The interstate access connection that permits an ISP to communicate with its subscribers falls within the scope of exchange access and, accordingly, constitutes an access service as defined by the FCC:

> *Access Service* includes services and facilities provided for the origination or termination of <u>any</u> interstate or foreign telecommunications. (Emphasis added)

The fact that the FCC has exempted enhanced service providers, including ISPs, from paying interstate switched access charges does not alter the fact that the connection an ISP obtains is an access connection. Instead, the exemption limits the compensation that a LEC in providing such a connection can obtain from an ISP. Further, under the access charge exemption, the compensation derived by a LEC providing the service to an ISP has been limited to the rates and charges associated with business exchange services. Nevertheless, the ISP's service involves interstate communications. The ISP obtains a service that enables a communications path to be established by its subscriber. The ISP, in turn, recovers the cost of the telecommunications services it uses to deliver its service through charges it assesses on the subscribers of the ISP's service.

Where two or more carriers are involved in establishing the communications path between the ISP and the ISP's subscriber, the access service to the ISP is jointly provided. Such jointly provided access arrangements are not new or unique nor are the associated mechanisms to handle inter-carrier compensation. The services ISPs obtain for access to their subscribers are technically similar to the line side connections available under Feature Group A. For such line side arrangements, the FCC has relied on revenue sharing agreements for the purpose of inter-carrier compensation. The long history and precedent regarding inter-carrier compensation for interstate services are instructive and relevant to the FCC's determinations in this proceeding.

Q. PLEASE EXPLAIN FURTHER WHY A SEPARATE SHARING PLAN IS NEEDED FOR ACCESS SERVICE PROVIDED TO ISPs?

A. The need for a separate sharing plan is created by the FCC's decree that the price charged for access service provided to ISPs is the business exchange rate. Unlike other switched access services, which are billed on a usage-sensitive basis, business exchange service prices are flat-rated.

Because non-ISP switched access service is billed on a usage-sensitive basis, it is relatively easy for each carrier to be compensated for the portion of the access service that it provides. Generally, there are two methods used for such compensation. Under the first method, each carrier bills the IXC directly for the portion of access service provided. For example, for originating access, the originating LEC bills the IXC for the switching and for the portion of transport that the originating LEC provides, and the terminating LEC bills the IXC for the portion of transport that it provides. Under the second method, the terminating LEC bills the IXC for all of the access service, and the originating LEC bills the terminating LEC for the portion of access services that it provides.

With ISP traffic, these methods are unworkable. Since the ISP is billed business exchange service rates, only one LEC can bill the ISP. Also, since the rate paid by the ISP is a flat rate charge designed for another service, i.e., business exchange service, there is no structural correlation between the cost incurred by the LEC and the price paid by the ISP. However, the business exchange rate paid by the ISP is the only source of revenue to cover any of the costs incurred in provisioning access service to the ISP. Therefore, a plan to share the access revenue paid by the ISP among all the carriers involved in sending traffic to the ISP is needed.

Q. DOESN'T BELLSOUTH COVER THE COST OF ORIGINATING TRAFFIC TO ISPs FROM ITS OWN END USERS?

A. No, nor would it be appropriate to do so. Again, ISPs purchase access services, albeit at business exchange rates. The local exchange rates paid by end user customers were never intended to recover costs associated with providing access service and were established long before the Internet became popular.

Q. YOU HAVE STATED THAT IT IS NOT APPROPRIATE FOR THE COMMISSION TO ADDRESS ISP-BOUND TRAFFIC IN THE CONTEXT OF SECTION 251 OF THE ACT. SHOULD THE COMMISSION ADDRESS ISP-BOUND TRAFFIC AS ACCESS TRAFFIC?

A. If the Commission wishes to address this issue at all in this arbitration, it should be in the context of an interim compensation mechanism for ISP-bound access traffic. As I have stated previously, only local traffic is governed by Section 251 of the Act. ISP-bound traffic is not local traffic but is instead access traffic under the jurisdiction of the FCC. Therefore, the Commission could address ISP-bound traffic as access traffic by establishing an inter-carrier compensation mechanism. Such a mechanism would be interim until such time as the FCC completes its rulemaking proceeding on inter-carrier compensation.

Q. SHOULD THIS COMMISSION ADOPT AN INTERIM INTER-CARRIER COMPENSATION MECHANISM PRIOR TO THE FCC COMPLETING ITS RULEMAKING PROCEEDING, WHAT DOES BELLSOUTH PROPOSE AS AN APPROPRIATE INTERIM MECHANISM?

A. BellSouth proposes an interim flat-rated sharing mechanism that is based on apportionment of revenues collected for the access service among the carriers incurring costs to provide the service. The revenue to be apportioned among carriers is the charge for the business exchange service that the ISP pays. Typically, the ISP purchases Primary Rate ISDN ("PRI") service as the business exchange product used to provide the access service. BellSouth believes that, in the interim, a flat-rated compensation process is appropriate since the revenues collected are based on flat-rated charges. Exhibit AJV-6 attached to this testimony is BellSouth's Proposed Interim ISP Inter-Carrier Access Service Compensation Plan ("Interim Plan").

In describing BellSouth's Interim Plan, I use the term "Serving LEC" to refer to a LEC that has an ISP as an end user customer and the term "Originating LEC" to refer to a LEC whose end user customers originate traffic that is delivered to the Serving LEC's network and is bound for an ISP. BellSouth's Interim Plan takes into account the following facts:

1) Only the Serving LEC bills the ISP for access service. The ISP is billed at rates established by the Serving LEC;
2) The FCC has limited the price for an ISP dial-up connection to the equivalent business exchange service rate;
3) the Originating LEC incurs costs to carry ISP-bound traffic to the Serving LEC;
4) the Originating LEC has no means to recover its costs directly from the ISP (unless, of course, the Originating LEC and the Serving LEC are one in the same); and
5) The Originating LEC must recover its costs, to the extent possible, from the Serving LEC.

BellSouth's Interim Plan presumes that all LECs who serve ISPs will participate in the plan. Otherwise, only those parties that will benefit will participate – i.e., a LEC that originates more ISP-bound traffic than it transports to an ISP will be a net receiver.

Q. PLEASE DESCRIBE THE SPECIFICS OF BELLSOUTH'S INTERIM PLAN.

A. BellSouth's Interim Plan contains the following steps that are further described in Exhibit AJV-6:

(1) Each Serving LEC will be responsible for identifying all minutes of use ("MOUs") which are ISP-bound that each Originating LEC delivers to the Serving LEC's network;

(2) each trunk (DS0-equivalent) will be assumed to carry 9,000 MOUs on average per month (equates to 150 hours per trunk per month);

(3) based on ISP-bound MOUs identified by the Serving LEC and provided to the Originating LEC, the Originating LEC will calculate the quantity of DS1 facilities required to transport the Originating LEC's ISP-bound traffic to the Serving LEC as follows:

(ISP-bound MOUs / 9,000 MOUs per trunk / 24 trunks per DS1);

(4) Serving LEC will advise Originating LECs of the average PRI rate charged to ISPs. The Serving LEC can use either its tariffed rate or the average rate actually charged to ISPs;

(5) Originating LEC calculates compensation due to it by the Serving LEC as follows:

(Quantity of DS1s x Serving LEC's PRI rate x sharing percentage);

(6) Originating LEC bills the Serving LEC on a quarterly basis; and

(7) The ISP-bound MOUs and the PRI rates as reported by the Serving LEC are subject to audit by the Originating LEC(s). The amount of compensation could be affected by results of an audit.

To the extent two parties have additional issues, contract negotiations between the parties can determine other terms and conditions. For example, due to technical capabilities, the two LECs may agree that the Originating LEC will identify the ISP-bound minutes of use.

Q. WHAT IS THE BASIS FOR USING 9,000 MOUs AS THE AVERAGE MONTHLY USAGE PER TRUNK?

A. Nine thousand (9,000) MOUs is a proxy that was used by the FCC for FGA access before actual usage could be measured. Further, this average level of usage has been used in other situations as a proxy for IXC usage.

Q. WHAT SHARING PERCENTAGE DOES BELLSOUTH PROPOSE BE APPLIED TO THE SERVING LEC'S REVENUES TO COMPENSATE BELLSOUTH FOR ITS NETWORK USED TO CARRY ISP-BOUND TRAFFIC?

A. BellSouth proposes a sharing percentage of 8.6% that will be applied to the Serving LEC's ISP revenues to calculate the compensation due BellSouth when BellSouth is an Originating LEC. Likewise, when BellSouth is the Serving LEC, BellSouth proposes that a sharing percentage of 8.6% will be applied by the Originating LEC(s) when calculating compensation BellSouth owes.

Q. HOW DID BELLSOUTH DETERMINE THE SHARING PERCENTAGE IT PROPOSES?

A. BellSouth's calculation of its sharing percentage is shown in Exhibit AJV-7 attached to this testimony. First, BellSouth considered that switching, transport and loop costs are incurred to carry traffic from the Originating LEC's end office to the ISP location. Since the Serving LEC incurs the loop cost between its end office and the ISP location, the Serving LEC should retain revenues to cover its loop cost. However, switching and transport costs are jointly incurred by both the Originating LEC and the Serving LEC.

Therefore, BellSouth believes that an appropriate sharing percentage is developed by determining the ratio of switching and transport costs to total costs (switching, transport and loop), and then dividing that percentage by two since each carrier bears a portion of the switching and transport cost. In order to determine the ratio, BellSouth looked to the Benchmark Cost Proxy Model ("BCPM") results filed in Florida in the Universal Service Fund proceedings. The average, statewide voice grade loop, switching and transport capital costs produced by BCPM are $14.62, $2.90 and $.14, respectively. Therefore, the loop capital cost represents 82.8% of the total average statewide capital cost, which means that the switching and transport capital costs represent 17.2% of the total capital cost. Again, dividing the 17.2% by two in order to account for the fact that both carriers incur switching and transport costs results in a sharing percentage of 8.6%.

BellSouth also reviewed ARMIS data and determined that the relationship between loop, switching and transport investment as reported in ARMIS is very similar to the relationship calculated from the BCPM results. The ARMIS data shows that, for 1998, in Florida, total loop investment was $7,381,715,000, switching investment was $989,297,000 and transport investment was $182,062,000 resulting in ratios of 86.30% for loop, 11.57% for switching and 2.13% for transport which are close to the ratios that result from the BCPM data.

Q. DOES BELLSOUTH'S PROPOSED SHARING PERCENTAGE ONLY APPLY TO TRAFFIC IT ORIGINATES TO A SERVING LEC?

A. No. When BellSouth is the Serving LEC and a CLEC's end users call an ISP served by BellSouth, BellSouth should compensate the CLEC. BellSouth proposes to use the same method and sharing percentage (8.6%) to compensate the CLEC as it proposes for billing the CLEC.

Q. WHAT IMPACT WOULD BELLSOUTH'S PROPOSAL HAVE ON A CLEC SUCH AS ICG?

A. As an example, I will assume that ICG serves its ISP customers with PRI service which is equivalent to a DS1 (24 DS0s). Further, I will assume that ICG charges its ISP customers a market-based rate of $850 per month per PRI. If BellSouth as the Originating LEC generates 55 million ISP-bound MOUs per month to ICG, then the amount of monthly compensation that BellSouth's proposal would result in ICG owing to BellSouth is calculated as follows:

55,000,000 / 9000 / 24 = 254.63 DS1s

254.63 DS1s x $850.00 x .086 = $18,613.45

At a PRI rate of $850, ICG will collect $216,436 in revenue from its ISP customer(s) just for the traffic originated by BellSouth. Total compensation ICG owes to BellSouth for the 55,000,000 MOUs BellSouth originated to ICG would be $18,613.45.

Q. HOW DOES YOUR PROPOSAL AFFECT THE RELATIVE COST RECOVERY OF THE LECs INVOLVED IN PROVIDING THE ACCESS SERVICE?

A. Since the FCC has ordered that ISPs are to be provided service at business exchange rates, the fact is that when the access service is provided by a single LEC to the ISP, the rates it charges the ISP are typically not fully compensatory. This situation arises because the ISP is being charged a flat rate charge (which was intended for another service) for a high volume usage-sensitive service. Under BellSouth's sharing proposal, each carrier should recover roughly the same percentage of its costs. For example, if the carrier would have recovered 50% of its costs if it served the ISP alone, the underlying premise of this proposal is that each carrier should recover roughly 50% of its costs.

Q. SHOULD THIS PLAN BE CONTINUED ONCE THE FCC ESTABLISHES A USAGE-BASED COMPENSATION MECHANISM?

A. Probably not. The need for this plan was created by the fact that ISPs currently pay business exchange rates for access service. Should the FCC change the application of access charges to ISPs or establish a different compensation mechanism, this plan should be re-evaluated.

Q. IN LIGHT OF YOUR COMMENTS WHAT ACTION ARE YOU RECOMMENDING TO THE FLORIDA PSC?

A. The FCC has determined that ISP-bound traffic is interstate and has asserted jurisdiction. This issue is not subject to arbitration under Section 252 of the Act. Parties should be instructed to negotiate a revenue sharing arrangement for this traffic just as has been done for jointly-provided access service since divestiture. If those negotiations are not fruitful, however, they should be referred to the FCC. Should, however, this Commission adopt an interim inter-carrier compensation mechanism prior to the FCC completing its rulemaking proceeding, BellSouth recommends the Commission adopt the Interim Plan mechanism outlined above.

Q. IS BELLSOUTH ECONOMICALLY INDIFFERENT TO PAYING RECIPROCAL COMPENSATION ON ISP-BOUND TRAFFIC?

A. No. The Diagrams F and G described above should make clear that BellSouth is not economically indifferent to paying reciprocal compensation on ISP calls for the following reasons:

1) BellSouth is still incurring the cost to transport the call to the point of interconnection with the CLEC,
2) The CLEC wants BellSouth to pay reciprocal compensation to cover the CLEC's cost from the point of interconnection to the CLEC's switch, and
3) The ISP, which is the only source of revenue to cover the costs in 1) and 2) above, only pays the CLEC for access.

The CLEC receives the revenues from its ISP customer, yet ICG apparently believes it is appropriate for BellSouth to incur a portion of the costs for providing the service without any reimbursement. This is exactly the opposite of the situation depicted in Diagram B, which illustrates when reciprocal compensation should apply. The CLEC should reimburse the originating carrier (BellSouth) for its cost of transporting the ISP-bound call to the CLEC point of interconnection. Instead, the CLEC wants the LEC to incur even more of the costs without any compensation. This is a perversion of the entire access charge system. There is no reason for this Commission to sanction this economic legerdemain and reward CLECs by subsidizing ISPs at the expense of the LEC's end users.

Q. IF RECIPROCAL COMPENSATION IS NOT AUTHORIZED, WILL CLECs BE UNCOMPENSATED FOR THE COSTS THEY INCUR TO PROVIDE SERVICES TO ISPs?

A. No. The CLECs' ISP customers compensate the CLECs for services that are provided just like an ILEC's ISP customer compensates the ILEC. The CLECs' request for reciprocal compensation on ISP-bound traffic simply provides CLECs with unearned windfall revenues and further increases the unreimbursed cost of the ILEC.

Q. DOES LACK OF RECIPROCAL COMPENSATION ON ISP-BOUND TRAFFIC DISTORT THE ATTRACTIVENESS OF ISPs AS CLEC CUSTOMERS?

A. No. Payment of reciprocal compensation would create the distortion. The table below provides an illustrative example of this distortion.

	SERVING AN ISP AND RECEIVING RECIPROCAL COMPENSATION	***SERVING AN ISP WITHOUT RECEIVING RECIPROCAL COMPENSATION***
REVENUE FROM ISP FOR SERVICE	$600	$900
RECIPROCAL COMPENSATION REVENUE PAID	$300	$0
COST OF PROVIDING SERVICE TO ISP	($600)	($600)
NET MARGIN	$300	$300

What this illustration shows is that reciprocal compensation allows the CLEC to offer lower prices to ISPs without reducing their net margins. Reciprocal compensation subsidizes the prices the CLEC charges the ISP. When reciprocal compensation is not paid on ISP-bound traffic, all parties are competing on an equal footing for ISP customers. Hence, reciprocal compensation should not be used to subsidize the service provided to the ISP.

Q. IS BELLSOUTH ATTEMPTING TO AVOID PAYING RECIPROCAL COMPENSATION ON UNBALANCED TRAFFIC?

A. No. First, let me point out that BellSouth does not dispute payment of reciprocal compensation on unbalanced traffic. Rather, BellSouth disputes payment of reciprocal compensation on access traffic – i.e., ISP-bound traffic. Second, I would point out that BellSouth has an obligation to serve any customer, not simply to compete for the business of customers that generate more inbound than outbound calling as ICG does.

Issue 2: Should BellSouth be required to offset the amount paid by ICG in the Bona Fide Request process for BellSouth's costs in developing a project plan whenever other parties subsequently request and receive the same service at a reduced rate (because BellSouth has already developed the necessary project plan)?

Q. WHAT IS THE PURPOSE OF THE BONA FIDE REQUEST PROCESS WITH CLECs?

A. Bona Fide Requests/New Business Requests (BFR/NBR) are used to allow CLECs to request BellSouth to provide a new or modified network element, interconnection option, or other service pursuant to the Act, or to provide a new or a customized capability or function to meet a CLEC's business needs. The BFR/NBR process is intended to facilitate the two way exchange of information between the requesting party and BellSouth, which is necessary for accurate processing of requests in a consistent and timely fashion.

Q. DO CLECs MAKE USE OF THE BFR/NBR PROCESS?

A. Yes. During a nine-month period in 1998, BellSouth received and processed 2,663 BFR/NBR requests. Of those requests, however, only 88 were accepted, approved, developed, and implemented by CLECs.

Q. HOW IS THE COST OF A BFR/NBR DETERMINED?

A. A special team evaluates the CLEC's request for feasibility, consults with Product Managers, Subject Matter Experts, and others, and develops an estimate of the costs involved. Normally within 10 days after a BFR/NBR is received (maximum of 25 days based on complexity), BellSouth notifies the CLEC, in writing, if the request can be met and what the cost estimate is. If the CLEC accepts the offer, then the CLEC must pay for the time and development of the service or UNE.

Q. SHOULD BELLSOUTH BE REQUIRED TO RECOVER PART OF A CLEC's BFR/NBR COST FROM SUBSEQUENT COMPANIES USING THE SERVICE OR UNE?

A. No. To administer such a process for all BFR/NBRs would be extremely labor intensive and expensive and such a process is not required by the Act.

Q. IS IT DISCRIMINATORY FOR BELLSOUTH TO RECOVER THE BFR/NBR COST FROM THE FIRST CLEC TO REQUEST A NEW SERVICE OR UNE?

A. No. In most businesses, the first company to introduce or produce a new service or product absorbs expenses for planning, developing and testing such a product or service. Subsequently, other companies may make modifications or improvements and produce the same thing at a lower price, for example, computers or televisions. The benefit to the first requester is the ability to offer its product in the marketplace before other providers can enter the market. This same benefit applies on BFR/NBRs. BellSouth has no control over who submits a BFR/NBR first or how many subsequent CLECs will request the same product or service; therefore, BellSouth does not penalize or discriminate against the first CLEC to submit a BFR/NBR.

Q. DID ICG PROPOSE A SPECIFIC PLAN TO RECOVER COSTS ASSOCIATED WITH A BFR? IF SO, PLEASE DESCRIBE THE PLAN.

A. No. ICG did not propose a plan. Any such plan would involve keeping track of all BFR/NBRs presented by all CLECs, as well as subsequent purchasers of a BFR/NBR service or UNE in order to recover a portion of the developmental cost from the succeeding CLECs. This process would increase the cost of BFR/NBRs to all users. In one possible scenario, BellSouth would not know what portion of the BFR/NBR cost each subsequent purchasing company would pay, because BellSouth would not know how many, if any, other CLECs would want that particular service or UNE. Another possible scenario would involve keeping track of all CLECs buying a certain BFR/NBR service and reimbursing each one equally every time another CLEC purchases the service. This process would be even more administratively cumbersome and expensive than the first one. All of this administrative effort is unnecessary. The first requester already receives the same benefit that it would receive in any other marketplace.

Q. SHOULD BELLSOUTH PROPOSE AN ALTERNATIVE TO ALLOW A CLEC TO RECOVER PART OF THE BFR/NBR COSTS?

A. No. This is a process for which the CLEC should be responsible. In some cases, the CLEC requesting the BFR/NBR service or UNE may be the only CLEC to ever purchase or use the service or UNE. Even if other CLECs do purchase the new service or UNE at a later date, the initial CLEC has already had the advantage of implementing the service before anyone else.

Issue 3: Should BellSouth be required to make available as UNEs packet-switching capabilities, including but not limited to: (a) user-to-network interface ("UNI") at

56 kbps, 64 kbps, 128kbps, 256 kbps, 384 kbps, 1.544 Mbps, 44.736 Mbps; (b) network-to-network interface ("NNI") at 56 kbps, 64 kbps, 1.544 Mbps, 44.736 Mbps; and (c) data link control identifiers ("DLCIs"), at committed information rates ("CIRs") of 0 kbps, 8 kbps, 9.6 kbps, 16 kbps, 19.2 kbps, 28 kbps, 32 kbps, 56 kbps, 64 kbps, 128 kbps, 192 kbps, 256 kbps, 320 kbps, 320 kbps, 384 kbps, 448 kbps, 512 kbps, 640 kbps, 704 kbps, 768 kbps, 832 kbps, 896 kbps, 960 kbps, 1.024 Mbps, 1.088 Mbps, 1.152 Mbps, 1.216 Mbps, 1.280 Mbps, 1.344 Mbps, 1.408 Mbps, 1.472 Mbps, 1.536 Mbps, 1.544 Mbps, 3.088 Mbps, 4.632 Mbps, 6.176 Mbps, 7.720 Mbps, 9.264 Mbps, 10.808 Mbps, 12.350 Mbps, 13.896 Mbps, 15.440 Mbps, 16.984 Mbps, 18.528 Mbps, 20.072 Mbps?

Q. WHAT IS BELLSOUTH'S POSITION ON THIS ISSUE?

A. It is BellSouth's understanding that ICG is requesting that BellSouth unbundle its existing tariffed Packet Switching Frame Relay Service. Subject to the conditions stated in my testimony, BellSouth has agreed to do that. Ms. Caldwell is sponsoring studies for the functions as they are found in BellSouth's tariff. One Frame Relay rate element, Data Link Connection Identifier ("DLCI") is offered in BellSouth's tariff at varying Committed Information Rates ("CIRs"). BellSouth studied this functionality in "groupings" of CIRs that mirror its tariff offering. BellSouth's costs and proposed rates applicable during this interim period for unbundled packet switching capabilities are found on Exhibit AJV-8 attached to my testimony.

Issue 6: Should volume and term discounts be available for UNEs?

Q. WHAT IS BELLSOUTH'S POSITION ON THIS ISSUE?

A. BellSouth should not be required to provide volume and term discounts for UNEs. Neither the Act nor any FCC order or rule requires volume and term discount pricing. The UNE recurring rates that ICG will pay are cost-based in accordance with the requirements of Section 252(d) and are derived using least-cost, forward looking technology consistent with the FCC's rules. Furthermore, BellSouth's nonrecurring rates already reflect any economies involved when multiple UNEs are ordered and provisioned at the same time.

Issue 7: For purposes of reciprocal compensation, should ICG be compensated for end office, tandem, and transport elements of termination where ICG's switch serves a geographic area comparable to the area served by BellSouth's tandem switch?

Q. WHAT IS BELLSOUTH'S POSITION ON THIS ISSUE?

A. BellSouth's position is that if a call is not handled by a switch on a tandem basis, it is not appropriate to pay reciprocal compensation for the tandem switching function. BellSouth will pay the tandem interconnection rate only if ICG's switch is identified in the local exchange routing guide ("LERG") as a tandem. A tandem switch connects one trunk to another trunk and is an intermediate switch or connection between an originating telephone call location and the final destination of the call. An end office switch is connected to a telephone subscriber and allows the call to be originated or terminated. If ICG's switch is an end-office switch, then it is handling calls that originate from or terminate to customers served by that local switch, and thus ICG's switch is not providing a tandem function. ICG is seeking to be compensated for the cost of equipment it does not own and for functionality it does not provide. Therefore, this Commission should deny ICG's request for tandem switching compensation when tandem switching is not performed.

Q. PLEASE RESPOND TO ICG's CONTENTION THAT ICG'S SWITCH SERVES A GEOGRAPHIC AREA COMPARABLE TO BELLSOUTH'S TANDEM.

A. At the present time ICG is not collocated in any BellSouth central office in Florida. Therefore, it is not possible to determine whether ICG's switch would actually serve a geographic area comparable to BellSouth's tandem. If ICG intends to provide service in Florida similar to how they are providing service in Alabama then their switch would not serve an area comparable to BellSouth's tandem. In Alabama, ICG has collocation arrangements in only two of BellSouth's central offices. For ICG to imply that this equates to serving a geographic area comparable to BellSouth's tandem switch is inappropriate. ICG ignores the fact that BellSouth's Alabama tandem switch serves six central offices in addition to the two central offices ICG has chosen to serve. Obviously, the area served by BellSouth's tandem switch (eight central offices) is not comparable to the area ICG has elected to serve (two central offices). The clear intent of the FCC's order and rules is that if the

CLEC serves a geographic area comparable to the ILEC's tandem switch, the CLEC would be incurring comparable costs as the ILEC. ICG's service arrangement does not even approximate BellSouth's service scenario.

Q. PLEASE COMMENT ON ICG'S POSITION THAT ICG PROVIDES TRANSPORT BETWEEN ITS SWITCH AND ITS COLLOCATIONS.

A. Without specific information from ICG to the contrary, the equipment in ICG's collocation space is most likely nothing more than a Subscriber Loop Carrier ("SLC"). An SLC is part of loop technology and provides no "switching" functionality. Thus, ICG is only providing the termination function, which is not the same as transport from the ILEC tandem to end offices as ICG contends.

In paragraph 1039 of the FCC's First Report and Order, the FCC clearly defines transport:

> "We conclude that transport and termination should be treated as two distinct functions. We define 'transport' for purposes of section 251(b)(5), as the transmission of terminating traffic that is subject to section 251(b)(5) from the interconnection point between the two carriers to the terminating carrier's end office switch that directly serves the called party (or equivalent facility provided by the non-incumbent carrier)."

Further, in paragraph 1040 of the FCC's First Report and Order, "We define "termination" for purposes of section 251(b)(5), as the switching of traffic that is subject to section 251(b)(5) at the terminating carrier's end office switch (or equivalent facility) and delivery of that traffic from that switch to the called party's premises."

Additionally in that same paragraph, the FCC states:

"As such, we conclude that we need to treat transport and termination as separate functions – each with its own cost."

Clearly, the FCC recognized that transport and termination charges should apply only if those functions are provided. Transport includes any flat rated dedicated services, tandem switching function and "common" transport between the tandem switch and end office switch necessary to transport the call from the interconnection point to the end office. ICG's switch is not providing a common transport or tandem function, but is switching traffic through its end office for delivery of that traffic from that switch to the called party's premises.

Q. IS ICG'S POSITION CONSISTENT WITH WHAT THE FCC DETERMINED TO BE THE "ADDITIONAL COST" OF TERMINATING A CALL?

A. No. In paragraph 1057, the FCC clearly indicates what should be charged for terminating a call:

"We find that, once a call has been delivered to the incumbent LEC end office serving the called party, the 'additional cost' to the LEC of terminating a call that originated on a competing carrier's network primarily consists of the traffic-sensitive component of local switching. The network elements involved with the termination of traffic include the end-office switch and local loop. The costs of local loops and line ports associated with local switches do not vary in proportion to the number of calls terminated over these facilities. We conclude that such non-traffic sensitive costs should not be considered 'additional costs' when a LEC terminates a call that originated on the network of a competing carrier."

Obviously, the FCC intends for the terminating LEC to recover its loop costs from the end user customer, not the originating LEC. ICG is clearly attempting to recover its loop costs from BellSouth by inappropriately classifying their end office switch as a tandem switch.

ISSUE 9: In calculating PLU and PIU, should BellSouth be required to report the traffic on a monthly basis?

Q. ICG HAS STATED THEIR POSITION THAT THE PERCENT LOCAL USAGE (PLU) AND PERCENT INTERSTATE USAGE (PIU) SHOULD BE REPORTED ON A MONTHLY BASIS. WHAT ARE THE PLU AND THE PIU?

A. The PLU - Percent Local Usage - is a factor that determines the amount of local terminating minutes for use in mutual compensation billing. The PLU is calculated and reported quarterly as outlined in BellSouth's "Percent Local Use (PLU) Reporting Guidebook", in the "CLEC Activation Requirements" posted on the Internet, and in the interconnection agreement between BellSouth and ICG.

The PIU - Percent Interstate Usage - is a factor that is used to apportion charges between interstate and intrastate jurisdictions. It is the ratio of all interstate minutes of use to the total minutes of use. Once the PIU or interstate percentage is known, the intrastate percentage is calculated as 100% minus the PIU. The PIU is calculated and reported quarterly as outlined in BellSouth's effective Access Service tariffs approved in Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, North Carolina, South Carolina, Tennessee and by the FCC.

Q. ARE THE QUARTERLY PIU AND PLU REPORTING PROCEDURES REASONABLE AND EFFICIENT?

A. Yes. The quarterly PIU and PLU reporting requirements are both reasonable and efficient. Quarterly reporting is a reasonable balance of (1) the effort required by all companies (CLECs, IXCs and ILECs) to gather the data to calculate the PIU and PLU; (2) the effort required by companies to manually update their billing systems to include those factors for all other companies; and (3) the degree of variability of the factors within the reporting period, such as adds, disconnects, seasonal peaks, etc.

Q. SHOULD BELLSOUTH BE REQUIRED TO REPORT THE PIU AND PLU ON A MONTHLY BASIS?

A. No. To calculate and report PIUs and PLUs more often than quarterly, as called for in the tariffs, would require additional manpower and expense, and would not improve the current methodology.

Issue 10: Should BellSouth be required to provide to ICG a breakdown of the intrastate and interstate traffic that it reports to ICG?

A. Although it is unclear what relief ICG is really seeking, to the extent that ICG is asking for the underlying data that is used to calculate the PIU, the Interconnection Agreement provides for either BellSouth or ICG to conduct an annual audit to ensure the proper billing and reporting of traffic.

Issue 11: Should BellSouth be required to commit to provisioning the requisite network buildout and necessary support when ICG agrees to enter into a binding forecast of its traffic requirements in a specified period?

Q. WHAT IS BELLSOUTH'S POSITION CONCERNING ENTERING INTO A BINDING FORECAST WITH ICG?

A. BellSouth is currently analyzing the possibility of providing a service whereby BellSouth commits to provisioning the necessary network buildout and support when a CLEC agrees to enter into a binding forecast of its traffic requirements. While BellSouth has not yet completed the analysis needed to determine if this is a feasible offering, BellSouth is willing to discuss the specifics of such an arrangement with ICG.

Q. SHOULD THIS COMMISSION ORDER BELLSOUTH TO COMPLY WITH THIS ISSUE AS ICG HAS STATED IT?

A. No. Although BellSouth has been analyzing such an offering, BellSouth is not required by the Act to commit to a binding forecast with CLECs. While the specifics of such an arrangement have not been finalized, BellSouth is agreeable to continue to negotiate with ICG to meet their forecasting needs.

Issue 5: Should BellSouth be subject to liquidated damages for failing to meet the time intervals for provisioning UNEs?

Issue 19: Should BellSouth be required to pay liquidated damages when BellSouth fails to install, provision, or maintain any service in accordance with the due dates set forth in an interconnection agreement between the Parties?

Issue 20: Should BellSouth continue to be responsible for any cumulative failure in a one-month period to install, provision, or maintain any service in accordance with the due dates specified in the interconnection agreement with ICG?

Issue 21: Should BellSouth be required to pay liquidated damages when BellSouth's service fails to meet the requirements imposed by the interconnection agreement with ICG (or service is interrupted causing loss of continuity or

functionality)?

Issue 22: Should BellSouth continue to be responsible when the duration of service's failure exceeds certain benchmarks?

Issue 23: Should BellSouth be required to pay liquidated damages when BellSouth's service fails to meet the grade of service requirements imposed by the interconnection agreement with ICG?

Issue 24: Should BellSouth continue to be responsible when the duration of service's failure to meet the grade of service requirements exceeds certain benchmarks?

Issue 25: Should BellSouth be required to pay liquidated damages when BellSouth's fails to provide any data in accordance with the specifications of the interconnection agreement with ICG?

Issue 26: Should BellSouth continue to be responsible when the duration of its failure to provide the requisite data exceeds certain benchmarks?

Q. HAS THIS COMMISSION PREVIOUSLY ADDRESSED THE ISSUE OF LIQUIDATED DAMAGES?

A. Yes. This Commission has previously determined that the issue of "incentive payments" and/or liquidated damages is not subject to arbitration under Section

251 of the Act. In the AT&T/MCI Arbitration proceeding, the Commission concluded, "we should limit our consideration in this arbitration proceeding to the items enumerated to be arbitrated in Sections 251 and 252 of the Act, and matters necessary to implement those items. A liquidated damages provision does not meet that standard." (Order No. PSC-96-1579-FOF-TP, dated December 31, 1996, page 74). The Commission further concluded "it is not appropriate for us to arbitrate a liquidated damages provision under state law." (Id.)

Even if a penalty or liquidated damage award could be arbitrated, it is completely unnecessary. Florida law and Commission procedures are available, and perfectly adequate, to address any breach of contract situation should it arise.

Q. WHAT IS BELLSOUTH'S POSITION REGARDING LIQUIDATED DAMAGES?

A. Nothing has changed that makes the Commission's previous determination invalid. The Commission should not arbitrate this issue.

Q. WHAT IS BELLSOUTH'S POSITION REGARDING ICG's REQUEST FOR BELLSOUTH TO BE RESPONSIBLE FOR SERVICE FAILURES THAT EXCEED CERTAIN BENCHMARKS?

A. BellSouth believes that the only remedies appropriate for inclusion in an interconnection agreement are those to which the parties mutually agree. BellSouth is currently working with the FCC to finalize BellSouth's proposal for self-effectuating enforcement measures. This is a voluntary proposal made by BellSouth which would take effect on a state by state basis concurrent with approval for BellSouth to enter into long distance in each state and subject to acceptance by the FCC. This proposal should not, however, be interpreted in any way as BellSouth's admission that the Commission or FCC have the authority to impose self-executing penalties or liquidated damages without BellSouth's agreement.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

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BELLSOUTH TELECOMMUNICATIONS, INC.

REBUTTAL TESTIMONY OF ALPHONSO J. VARNER

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 990691-TP

SEPTEMBER 7, 1999

Q. PLEASE STATE YOUR NAME, YOUR POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC. ("BELLSOUTH") AND YOUR BUSINESS ADDRESS.

A. My name is Alphonso J. Varner. I am employed by BellSouth as Senior Director for State Regulatory for the nine-state BellSouth region. My business address is 675 West Peachtree Street, Atlanta, Georgia 30375.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS DOCKET?

A. Yes. I filed direct testimony and seven exhibits on August 2, 1999.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony rebuts portions of the direct testimony filed by ICG Telecom Group, Inc. ("ICG") witnesses Michael Starkey, Bruce Holdridge and Karen Notsund filed with the Florida Public Service Commission ("Commission") on August 2, 1999.

Q. ON PAGE 11, MR. STARKEY STATES THAT ISP-BOUND TRAFFIC IS FUNCTIONALLY NO DIFFERENT THAN OTHER TYPES OF TRAFFIC FOR WHICH BELLSOUTH HAS AGREED TO PROVIDE RECIPROCAL COMPENSATION. IS HE CORRECT?

A. No. Mr. Starkey is incorrect. Traffic bound for the Internet for Internet Service Providers ("ISP-bound traffic") is functionally equivalent to access traffic, not local traffic. As I stated in my direct testimony, only local traffic is subject to reciprocal compensation obligations. As previously confirmed by the Federal Communications Commission's ("FCC") Declaratory Ruling, ISP-bound traffic is jurisdictionally interstate; therefore, reciprocal compensation for ISP-bound traffic under Section 251 is not applicable.

Q. MR. STARKEY EXPLAINS ON PAGE 17 THAT CALLS DIRECTED TO ISPs ARE FUNCTIONALLY IDENTICAL TO LOCAL VOICE CALLS FOR WHICH BST HAS AGREED TO PAY TERMINATION CHARGES. DO YOU AGREE?

A. To the extent this statement is correct, the same could be said of a call to an interexchange carrier's ("IXC's") point of presence ("POP"). Mr. Starkey would agree that such calls to an IXC's POP are not subject to reciprocal compensation. It is not the technical use of the facilities that is relevant here, rather it is the nature of the traffic. Just like IXC traffic, ISP-bound traffic is originating access traffic.

Q. AT PAGE 8 OF HIS TESTIMONY, MR. STARKEY QUOTES FROM PARAGRAPH 25 OF THE FCC'S DECLARATORY RULING IN AN ATTEMPT TO SHOW THAT THIS COMMISSION SHOULD APPLY RECIPROCAL COMPENSATION TO ISP-BOUND TRAFFIC IN THE PARTIES' INTERCONNECTION AGREEMENT. PLEASE COMMENT.

A. Mr. Starkey's use of paragraph 25 is incorrect. The basis for paragraph 25 is to advise the state commission that, in the absence of a federal rule governing ISP-bound traffic, states may "at this point" determine how ISP traffic should be treated in interconnection agreements. In other words, to do so would not violate any federal rule "at this point." However in its NPRM, the FCC asked for comment from the parties as to whether it is proper for states to address ISP traffic in arbitration proceedings. BellSouth believes it is not within the states' authority to do so and the FCC lacks the power to vest that authority with the state commissions. In any event, the FCC notes that decisions by the states must be consistent with federal law and that states must comply with the FCC's rules when adopted.

In light of this instruction to the states, it is important to emphasize the FCC's position as stated in footnote 87 of its Declaratory Ruling: "We conclude in this Declaratory Ruling, however, that ISP-bound traffic is non-local interstate traffic. Thus, the reciprocal compensation requirements of section 251(b)(5) of the Act and Section 51, Subpart H (Reciprocal Compensation for Transport and Termination of Local Telecommunications Traffic) of the Commission's rules do not govern inter-carrier compensation for this traffic." The inescapable conclusion that this Commission must reach is that the FCC has exercised jurisdiction over ISP-bound traffic and footnote 87 states that ISP-bound traffic is not subject to reciprocal compensation. Instead, ISP-bound traffic will be subject to an inter-carrier compensation mechanism more appropriate to interstate access traffic.

Q. MR. STARKEY FURTHER QUOTES FROM PARAGRAPH 25 IN AN ATTEMPT TO SHOW THAT THE FCC WAS ENCOURAGING STATES TO APPLY RECIPROCAL COMPENSATION TO ISP-BOUND TRAFFIC. DO YOU AGREE?

A. No. The FCC is not at all encouraging the states to adopt reciprocal compensation for ISP-bound traffic in paragraph 25. Footnote 87 clearly demonstrates the fallacy of Mr. Starkey's conclusion. Instead, the FCC is simply explaining why it believes those states that ruled that reciprocal compensation is applicable to ISP-bound traffic could have done so. Paragraph 25 states in part, "[w]hile to date the Commission has not adopted a specific rule governing the matter, we do note that our policy of treating ISP-bound traffic as local for purposes of interstate access charges would, if applied in the separate context of reciprocal compensation, suggest that such compensation is due for that traffic." The rest of the Order, however, goes on to say conclusively that such a conclusion is inaccurate. The FCC was simply advising the states that it could understand how its failure to adopt a specific rule could be a reason that the states might not have fully understood the FCC's previous decisions that ESP/ISP traffic is access traffic.

Q. MR. STARKEY AT PAGE 16 IMPLIES THAT A CLEC WOULD NOT HAVE ANY COST RECOVERY ASSOCIATED WITH SERVING AN ISP PROVIDER IF NOT FOR THE RECIPROCAL COMPENSATION IT RECEIVES FROM ILECS. DO YOU AGREE?

A. No. ISPs are carriers. As carriers, ISPs obtain access services from their serving local exchange carrier ("LEC"). The rates ISPs pay their serving LEC covers the full charge for the service provided to them. When an IXC or an ISP purchases access service, it is the IXC or the ISP, not the end user, who is the customer of the LEC for that service. The revenue the LEC receives from the ISP for access services is the only means to recover the costs of delivering the traffic to the ISP. Any additional compensation would only serve to augment the revenues the LEC receives from its ISP customer at the expense of the originating LEC's end user customers. In other words, paying ICG reciprocal compensation for ISP-bound traffic would result in BellSouth's end user customers subsidizing ICG's operations. Indeed, the FCC has recognized that the source of revenue for transporting ISP-bound traffic is the charge that the ISP pays for the access service. Further compensation to the ISP-serving LEC is inappropriate and is not in the public interest.

If ICG is not recovering its cost from the ISPs it serves, it is likely that ICG is charging below cost rates to those ISPs. Apparently ICG's complaint is that it will no longer be able to charge below cost rates when the subsidy it received from BellSouth in the form of reciprocal compensation goes away. Obviously, such complaint provides no basis for continuing the subsidy. However, it does clearly show why such subsidies should not be established, because once they are established, they become difficult to remove.

It is difficult to empathize with ICG's situation. BellSouth has been an access service provider for ESPs and ISPs for years. Though BellSouth has been unable to collect the otherwise applicable switched access charges due to the FCC's exemption, BellSouth's source of cost recovery has been the business exchange service rates it charges ISPs.

Q. DOES MR. STARKEY CONTRADICT HIS OWN CLAIM THAT ALECs DO NOT RECOVER COSTS FROM ISPs?

A. Yes. Interestingly, Mr. Starkey directly contradicts his contention that alternative local exchange carriers ("ALECs") do not recover their costs from ISPs. The contradiction is found in the following comment at page 14: "Indeed, ISPs and other technologically reliant customer groups are, in many cases, providing the revenue and growth potential that will fund further ALEC expansion into other more traditional residential and business markets." If ALECs are not recovering their cost to provide service to ISPs, what is the source of the revenue to fund expansion? The revenue comes from ALECs like ICG soaking ILECs for inappropriate reciprocal compensation payments on non-local ISP-bound access traffic. The Commission should see this situation for what it is. ICG is asking this Commission to require BellSouth to fund ICG's business operations and expansion plans. Such a scheme creates a market distortion that should not be allowed to occur. If ICG's recommendation is adopted, ICG wins, ISPs win and BellSouth's end user customers lose and, ultimately, competition in the local exchange suffers. Reciprocal compensation for ISP-bound traffic sets up a win-win-lose situation, versus an appropriate inter-carrier compensation sharing mechanism, which establishes a win-win-win situation.

Q. AT PAGE 20, MR. STARKEY TAKES A DIFFERENT TACK, SETTING UP A HYPOTHETICAL SITUATION WHERE BELLSOUTH IS THE ONLY LOCAL PROVIDER AND SERVES ALL ISP CUSTOMERS. HE CONTENDS THAT FOR BELLSOUTH TO MEET THE INCREASED NETWORK REQUIREMENTS CAUSED BY ISPS, BELLSOUTH WOULD "UNDOUBTEDLY BE ASKING STATE COMMISSIONS AND THE FCC FOR RATE INCREASES TO RECOVER THOSE ADDITIONAL INVESTMENT COSTS." DO YOU AGREE?

A. No. BellSouth is not arguing that routing traffic through an ISP should be done for free. In Mr. Starkey's hypothetical case, BellSouth would be receiving revenues from the ISP for the access service. When ICG serves that ISP, a portion of those revenues should be used to compensate BellSouth for the costs incurred.

Q. MR. STARKEY STATES THAT BELLSOUTH SHOULD BE

"ECONOMICALLY INDIFFERENT AS TO WHETHER IT ITSELF INCURS THE COST TO TERMINATE THE CALL ON ITS OWN NETWORK OR WHETHER IT INCURS THAT COST THROUGH A RECIPROCAL COMPENSATION RATE PAID TO ICG". PLEASE RESPOND. (PAGES 11, 19-20)

A. Mr. Starkey leaves out one very important point. When BellSouth uses its own network to route calls to a BellSouth served ISP, it charges the ISP business exchange rates. It is not able to recover its cost from the end user that places the call. When an ALEC serves the ISP, only the ALEC receives revenues for the access service provided to the ISP. Although BellSouth incurs cost for delivering BellSouth end user calls to the ALEC, under reciprocal compensation BellSouth is unable to recover that cost. This is why it is so important that access service revenues, such as for ISP-bound traffic, be shared among the carriers that jointly provide the service. As I stated earlier, ICG should reimburse the originating carrier (BellSouth) for its cost of transporting the ISP-bound call to ICG's point of interconnection. Instead, ICG wants BellSouth to incur even more of the costs without receiving any of the compensation. This is a perversion of the entire access charge system that this Commission should not allow to occur.

Q. MR. STARKEY STATES ON PAGE 17 THAT IT IS A SIMPLE ECONOMIC REALITY THAT BOTH ISP CALLS AND OTHER CALLS GENERATE EQUAL COSTS THAT MUST BE RECOVERED BY THE RECIPROCAL COMPENSATION RATE PAID FOR THEIR CARRIAGE.

DO YOU AGREE?

A. No, this statement is wrong. Costs for calls directed to ISPs are to be recovered from the ISP, rather than the originating end user. Costs for local calls are recovered from the originating end user. This fact means that reciprocal compensation is inappropriate for ISP-bound calls. In the case of a call sent from BellSouth to an ISP served by ICG, ICG is the only carrier collecting revenue for the ISP-bound calls. In the case of a local call directed from a BellSouth end user to an ICG end user, BellSouth would be the only carrier collecting revenue. Mr. Starkey ignores this important point and claims that the only carrier collecting revenue for ISP-bound calls should receive more revenue.

Q. CONTRARY TO MR. STARKEY'S CONTENTION, WHY IS IT POOR PUBLIC POLICY TO REQUIRE THE PAYMENT OF RECIPROCAL COMPENSATION FOR ISP TRAFFIC? (PAGES 10-11)

A. In paragraph 33 of its ISP Declaratory Ruling, the FCC stated its desire that any inter-carrier compensation plan advance the FCC's "goals of ensuring the broadest possible entry of efficient new competitors, eliminating incentives for inefficient entry and irrational pricing schemes, and providing to consumers as rapidly as possible the benefits of competition and emerging technologies." In fact, payment of reciprocal compensation on ISP-bound traffic would be contrary to the FCC's stated goals for the following reasons:

- Reduces incentive to serve residence and business end user customers;

- Further subsidize ISPs;
- Encourages uneconomic preferences for ALECs to serve ISPs due to the fact that ALECs can choose the customers they want to serve and ALECs could offer lower prices to ISPs without reducing the ALEC's net margin;
- Increases burden on end user customers;
- Establishes unreasonable discrimination among providers (IXCs versus ISPs);
- ILEC is not compensated for any costs incurred in transporting ISP-bound traffic; and
- Creates incentives to arbitrage the system, such as schemes designed solely to generate reciprocal compensation.

Q. AT PAGE 13, MR. STARKEY ATTEMPTS TO BUILD A CASE FOR WHY ISP PROVIDERS SEEK OUT ALECS. PLEASE COMMENT.

A. In attempting to show why ISPs seek out ALECs to provide their access service versus ILECs such as BellSouth, Mr. Starkey merely succeeds in demonstrating why ALECs should not be subsidized by the ILEC through reciprocal compensation. Mr. Starkey says that ALECs attract ISPs' business because ALECs provide the service, products, technology, capacity, flexibility and low prices that ISPs desire. If, in fact, all of this is true, ICG should be able to attract ISP business even more easily than they attract other business customers. Why then is it necessary for ICG to receive a subsidy from BellSouth when it can so easily attract ISPs due to ICG's inherent advantages? In fact, if these advantages are so significant, ICG should be able to charge a higher price than BellSouth charges and still win the ISPs' business.

Q. FURTHER, ON PAGE 22, MR. STARKEY STATES, "HOWEVER, IN THE CASE OF RECIPROCAL COMPENSATION, IT HAS COME TO BST'S ATTENTION THAT IT HAS BECOME, IN MANY CASES, A NET PAYOR OF TERMINATION CHARGES BECAUSE ALECS HAVE BEEN SUCCESSFUL IN ATTRACTING ISP PROVIDERS AND OTHER TECHNOLOGICALLY DEMANDING CUSTOMERS. HENCE, IF INDEED ITS RATES FOR TRAFFIC TRANSPORT AND TERMINATION ARE OVERSTATED, IT BECOMES THE PARTY MOST LIKELY TO BE HARMED." WHAT IS YOUR RESPONSE?

A. The above statement is wrong. Reciprocal compensation does not apply to access traffic. BellSouth is not arguing for a lower reciprocal compensation rate for this traffic. BellSouth is not objecting to paying reciprocal compensation simply because ISPs have a high volume of incoming traffic. BellSouth has not objected to paying reciprocal compensation for end users with these characteristics (e.g., pizza delivery service, etc.). BellSouth, however, is objecting to paying reciprocal compensation on access traffic because it is not applicable and is not in the public interest.

Q. MR. STARKEY CONTINUES ON PAGE 25 BY STATING, "THE APPROPRIATE WAY FOR BST TO MITIGATE ITS 'NET PAYOR' STATUS FOR RECIPROCAL COMPENSATION IS NOT TO SIMPLY REFUSE TO PAY FOR ITS CUSTOMERS' USE OF THE ICG NETWORK,

BUT INSTEAD TO FOLLOW THE DEMANDS OF THE COMPETITIVE MARKETPLACE JUST AS ICG AND THE LONG DISTANCE COMPANIES HAVE." WHAT IS YOUR RESPONSE?

A. ICG proposes to distort the marketplace by requiring reciprocal compensation where it is inappropriate. Instead of removing distortion, their proposal creates distortion in the form of subsidies to ISPs.

Q. WHAT IS YOUR RESPONSE TO MR. STARKEY'S ARGUMENT ON PAGES 26-27 THAT, BECAUSE OF BELLSOUTH'S SUCCESS IN ADDING SECOND LINES, BELLSOUTH SHOULD PAY RECIPROCAL COMPENSATION FOR ISP-BOUND TRAFFIC?

A. None of this discussion is relevant to the issue at hand. These second lines are no different from first lines when it comes to the question of who should pay for access traffic. This entire discussion is irrelevant to the issue of reciprocal compensation.

Q. HOW DO YOU RESPOND TO MR. STARKEY'S CONTENTION THAT BELLSOUTH.NET'S "UNLIMITED USAGE" RATES ARE FAR BELOW OTHER COMPETITIORS?

A. Mr. Starkey is clearly misinformed. It is obvious by the newspaper advertisements contained in Exhibit AJV-1 attached to this testimony, that BellSouth.net's rates are not out of line with other ISPs.

Q. REFERING TO DIAGRAM 3 IN HIS TESTIMONY, MR. STARKEY CONTENDS ICG PERFORMS TRANSPORT FUNCTIONS IN ADDITION TO SWITCHING FUNCTIONS. PLEASE RESPOND.

A. Diagram 3 clearly reflects that ICG's Lucent 5ESS switch is functioning only as an end office switch. Without specific information from ICG to the contrary, the "piece of equipment" in ICG's collocation cage appears to be nothing more than a Subscriber Loop Carrier which is part of loop technology and provides no "switching" functionality. ICG's switch is not providing a transport or tandem function, but is switching traffic through its end office for delivery of traffic from that switch to the called party's premises. This is the same conclusion the Commission determined in its Metropolitan Fiber Systems of Florida, Inc. ("MFS") and Sprint arbitration order. The Commission determined that "MFS should not charge Sprint for transport because MFS does not actually perform this function." (Order No. PSC-96-1532-FOF-TP, issued December 16, 1996) The circumstances in the MFS/Sprint arbitration case can be logically extended to the issue raised by ICG in this arbitration proceeding. In fact, the Commission reaffirmed this conclusion when it issued its Order in the MCI/Sprint arbitration case in Docket No. 961230-TP (Order No. PSC-97-0294-FOF-TP, issued April 14, 1997) The evidence in the record does not support ICG's position that its switch provides the transport or tandem switching elements; and the Act does not contemplate that the compensation for transporting and terminating local traffic should be symmetrical when one party does not actually use the network facility for which it seeks compensation. Any decision by this Commission should be consistent with its previous rulings.

Q. AT PAGE 32, MR. STARKEY STATES THAT ICG SHOULD BE PAID THE SAME TANDEM TERMINATION RATE AS PAID TO BELLSOUTH EVEN THOUGH ICG ONLY USES ONE SWITCH. PLEASE COMMENT.

A. In the MFS/Sprint order referenced above, the Commission found, "[s]ince MFS has only one switch, there technically can be no transport." ICG only has one switch. As was the case with MFS, technically there can be no transport since ICG has only one switch and, therefore, ICG is not entitled to compensation for transport and tandem switching unless it actually performs each function.

Q. PLEASE RESPOND TO MR. STARKEY'S CONTENTION THAT VOLUME AND TERM COMMITMENTS BY ICG WOULD REDUCE THE TELRIC PRICES.

A. There is no rational basis for ICG's position. The basic flaw in Mr. Starkey's analysis is that he assumes that TELRIC prices were based on network costs as they <u>are</u> instead of what they are <u>projected to be.</u> For example, Mr. Starkey's claim that a volume commitment by ICG would increase the utilization of plant ignores the way the costs were developed. Plant utilization in the study represents this Commission's view of plant utilization in the future. Any impact of volume requested by ICG is already included in this utilization percentage.

Q. PLEASE RESPOND TO MR. STARKEY'S CONTENTION THAT LONG-TERM COMMITMENTS BY ICG WOULD MINIMIZE BELLSOUTH'S RISK OF STRANDED INVESTMENT.

A. Mr. Starkey is basing his conclusion on an incorrect understanding of the cost studies. He is correct that in the retail world the risk of stranded plant costs would be reduced by a term commitment. However, none of the costs that a term commitment would reduce are included in TELRIC. Therefore, the impact of any reduction, even if it exists, is irrelevant with respect to UNE prices. The other major point that Mr. Starkey misses is that retail prices typically exceed costs. Consequently, discounts due to term commitments simply reduce the level of contribution, not the level of costs. UNE prices do not include any contribution. And since there are no savings of TELRIC costs, there is no basis for offering term discounts.

Q. MR. HOLDRIDGE CONTENDS THAT BELLSOUTH SHOULD BE HELD TO ALL INTERVALS, RESPONSIBILITIES AND LEVELS OF SERVICE TO WHICH BELLSOUTH COMMITS IN THE AGREEMENT, INCLUDING ANY STANDARDS IT COMMITS TO THAT EXCEED ITS COMMITMENTS TO ITS OWN CUSTOMERS. PLEASE RESPOND.

A. The Telecommunications Act of 1996 ("the Act") cites three standards by which ILECs are to be held accountable. The first is that ILECs will provide access to services in "substantially the same time and manner" ALECs), that it provides to the ILEC's own retail customer, FCC 96-325, First Report and Order, Adopted August 1, 1996, § V.5, ¶ 518. The second standard requires that an ILEC will "provide an efficient competitor a meaningful opportunity to compete", FCC 96-325, Second Order for Reconsideration, Adopted December 13, 1996, § I., ¶ 9. Finally, ILECs are to provide interconnection services that are "equal in quality" to that which ILECs provide themselves, FCC 96-325, First Report and Order, Adopted August 1, 1996, § IV.H, ¶ 224. No where does the Act suggest, as Mr. Holdridge contends, that an ILEC should commit to any standards that exceed its commitments to its own customers.

Q. WHAT IS BELLSOUTH'S POSITION REGARDING ICG'S PROPOSED STANDARDS ATTACHED TO MR. HOLDRIDGE'S TESTIMONY AS EXHIBIT I?

A. BellSouth believes that the standards proposal submitted by ICG is both overly burdensome and complicated and that the escalating scale of enforcement penalties is excessive. The purpose of penalties, if agreed to by any ILEC, is to reimburse the ALEC for discriminatory treatment, not to create a financial windfall for the ALEC.

Q. ON PAGE 7, MS. NOTSUND REQUESTS THAT THIS COMMISSION NOT ARBITRATE THIS ISSUE BUT RATHER INITIATE A GENERIC

PROCEEDING TO CONSIDER APPROPRIATE PERFORMANCE MEASUREMENTS AND ENFORCEMENT MECHANISMS. PLEASE RESPOND.

A. BellSouth agrees with ICG that this issue should not be arbitrated. As this Commission recently concluded in the MediaOne/BellSouth Arbitration proceeding (Docket No. 990149-TP), it lacks the authority under state law to impose liquidated damages provisions in arbitrated agreements.

Regarding Ms. Notsund's request for the initiation of a generic proceeding to address this issue, the Commission's Order in Docket No. 960786-TL dated August 9, 1999, adopted the Commission Staff's Proposal for Independent Third Party Testing of BellSouth's Operations Support Systems. This Order concluded that the testing plan would be used to determine whether BellSouth had established adequate performance measures. Even though the Commission may choose to address performance measurements in a generic proceeding, the fact remains that this Commission lacks the statutory authority to impose liquidated damages or penalty requirements regardless of whether the issue is addressed in a generic proceeding or an arbitration proceeding.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

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BY MR. KITCHINGS:

Q Mr. Varner, did you prepare a summary of your testimony?

A Yes.

Q Would you please give that at this time?

A Yes. Good afternoon. My summary is going to address the remaining issues that are in this arbitration, and I will begin with the ISP issue, which we have already heard so much about.

And the first thing I want to stress about that is that it is not the same issue that you have heard in these complaint proceedings, as I'm sure you are aware. You have dealt with the issue of contract interpretation. In this case there is no contract. So the issue here is what is the appropriate policy on how this traffic should be treated in a new agreement.

Now, many of the discussion around this, of course, centers around the FCC's declaratory ruling. And in the ruling the state commissions were given authority to establish an interim compensation arrangement for this traffic. However, the FCC did not relinquish jurisdiction, and said that they would, in fact, establish a compensation mechanism at some point in time. So any arrangement that the state commission implements will apply at best until the FCC composes its own solution.

Now, the reason I say at best is because BellSouth believes that the FCC does not have the authority to grant or the power to grant authority to the states to develop an interstate compensation mechanism. For example, the FCC clearly states that ISP traffic is not governed by Section 251 of the Telecom Act. However, they also say that states can design a mechanism in arbitrations which should be limited solely to Section 251 obligations.

In any event, the courts will eventually decide this issue. If this Commission closes to craft a mechanism subject to this tenuous authority, I believe the Commission's focus here should be to design a mechanism that best serves the public interest. And ICG claims that the same reciprocal compensation mechanism that applies to local traffic should apply to this ISP traffic.

BellSouth proposes that neither party would bill compensation for this traffic until the FCC issues its rules. Contrary to ICG's claim, they would not go without compensation for this period. In fact, it is BellSouth who would be the uncompensated party. Each party would agree to apply the FCC's arrangement retroactively to the approval date of the agreement.

Now, if the Commission adopts --

MR. KRAMER: Excuse me, Commissioner, may I interrupt?

COMMISSIONER DEASON: Yes.

MR. KRAMER: That was not contained in your prefiled testimony. I'm wondering if you are meaning to insert it back in because of the strike.

THE WITNESS: No, that was in the prefiled testimony.

COMMISSIONER DEASON: You are seeking clarification as opposed to objecting at this point?

MR. KRAMER: I am seeking clarification as opposed to a strike, right. I just want to find out what's going on.

COMMISSIONER DEASON: Mr. Varner, can you show us in your prefiled testimony that has not been stricken, your reference to the subject matter that you have just summarized?

THE WITNESS: I was just looking for it.

MR. KRAMER: That's what I did, too. I started to look twice and said, gee, wasn't it right there?

MR. KITCHINGS: If I may interrupt. If you will take a look at -- it looks like 15 and 16 may get to where you are trying to go on the Varner direct. And, again, excuse the interruption.

THE WITNESS: I don't see it.

COMMISSIONER DEASON: Does counsel have an objection?

MR. KITCHINGS: For what purpose, Mr. Kramer?

MR. KRAMER: This is the Alabama testimony, and the paragraph that I think Mr. Varner is looking for, I can show him where it was in this testimony.

MR. KITCHINGS: Sure, go ahead.

MR. KRAMER: I think we agree it is not in the testimony, so the question is how do we want to proceed on it now?

COMMISSIONER DEASON: Mr. Varner, you agree that the proposal to retroactively have the final decision apply is not in your prefiled testimony?

THE WITNESS: That is correct. It was inadvertently omitted. I thought it was in there and we have made that in every one of these arbitrations with ICG as well as in negotiations and it was inadvertently omitted.

COMMISSIONER DEASON: Very well. Well, if it is not in your testimony, you cannot summarize it.

THE WITNESS: Yes.

COMMISSIONER DEASON: You may proceed with the remainder of your summary.

THE WITNESS: Thank you. Yes. I want to proceed to examine the merits of ICG's and BellSouth's proposals. Now, ICG has not described any public policy benefit for applying reciprocal compensation to

ISP traffic. They propose this arrangement because they claim that the ISP traffic is local traffic.

Now, contrary to there assertions, the FCC has made it very clear that ISP-bound traffic is not local. There are at least five cites to that effect in the FCC's February 26 declaratory ruling. And I wanted to go through just a few of them.

In Paragraph 5, "Although the Commission has recognized that enhanced service providers (ESPs), including ISPs, use interstate access services." Paragraph 5, again, "Thus, ESPs generally pay local business rates and interstate subscriber line charges for their switched access connections."

Paragraph 16, "The Commission traditionally has characterized the link from an end user to an ESP as an interstate access service." Paragraph 16, again, "That the Commission exempted ESPs from access charges indicates this understanding that ESPs, in fact, use interstate access service. Otherwise the exemption would not be necessary." And finally, Paragraph 17, "The Commission consistently has characterized ESPs as users of access service, but has treated them as end users for pricing purposes."

Nowhere in the FCC's order does it say that ISPs or end users or that they use local service. It says that they have been treated as end users for pricing purposes only. Its references to treating them as end users and treating such traffic as local for pricing purposes simply means that under their access charge regime, ISPs don't pay access charges. It doesn't mean that the traffic is local or that the ISPs are end users.

ICG's claim apparently rests on their view that the FCC is wrong in this conclusion. However, the FCC established the access charge regime and are certainly able to define which traffic it applies to.

Now, since ISP-bound traffic is not local, let's examine whether reciprocal compensation should apply to this traffic. First, there is no requirement to apply reciprocal compensation to this traffic. Footnote 87, which you have already heard quoted several times today, clearly states that the reciprocal compensation obligations of the act do not apply on this traffic.

Second, applying reciprocal compensation to ISP traffic would not be sound public policy. And to explain why it isn't sound public policy, I want to begin by examining why reciprocal compensation was designed for local traffic only in the first place. And to do that, I am going to use these diagrams that were attached to my testimony. I'm not going to through all of them, I'm just going to use three of them. The first one being Diagram B, which is at the bottom of the first page.

Now, what that diagram does is it illustrates a local call involving multiple carriers. For example, BellSouth and ICG. And assume that the BellSouth end user is on the left and the ICG end user is on the right. If a BellSouth customer originates a call to an ICG customer and they pick up the phone and they dial the ICG customer's number, both BellSouth and ICG incur costs in handling that call, but only BellSouth bills the end user. ICG incurs a cost, but they have nothing to bill. The end users typically aren't billed for terminating usage.

Reciprocal compensation was developed as a means to facilitate cost recovery by ICG in this circumstance, when they were incurring a cost but they had no one to bill. And there is no dispute over this point, that this is what -- that reciprocal compensation was, in fact, designed to handle this kind of situation.

So it was -- in short, reciprocal compensation was designed to compensate the terminating carrier for costs caused by the originating carrier's customer.

The originating carrier collects all of the revenue from the customer and should share some of that revenue with the terminating carrier.

Now, let's examine whether ISP-bound traffic fits this pattern. And for that one I will use Diagram F, which is on the third page. And what that diagram illustrates is a call that is being made to a carrier, that a carrier is handling, and there are two companies involved. And, again, let's assume BellSouth is on the left and the ICG is on the right, where it says ICO or CLEC central office. And you have an ISP on the right, it could be an ISP or an IXC.

There are several different types. This is what access service is and what this illustrates is access service provided to an ISP involving multiple carriers. And there are several different types of carriers that use access services. ESPs use it, ISPs use it, interexchange carriers use it. For the FCC, all of these carriers use access service, but they don't all pay the same price for it. Some of them pay switched access charges, some of them pay business local exchange rates.

The important point, though, to look at when you are trying to determine whether reciprocal compensation fits here is who is the customer here? The end user is the ISP's customer on these calls. When a customer buys basic local exchange service from BellSouth, and pays $10.65 a month, they don't get Internet access. In order to get Internet access, they have to contact AOL, or Mind Spring, or BellSouth.net or someone like that in order to get interstate access service.

Interstate access service is not provided by the local carrier, it is provided by the ISP. What happens is that the ISP is using the local carrier's network. In this example they are using BellSouth and ICG's network in order to collect the traffic that they are in turn billing the end user for. The end user is their customer on this call. The ISP is billing them, and it is the ISP who is the cost causer on the telecommunications company's network. It is not the end user.

Now, instead of access charges, the FCC has said that the ISPs pay business local rates for this access service, whereas interexchange carriers would pay switched access charges for this service. If ICG serves the ISP, which they do in this example, ICG bills the ISP. BellSouth doesn't bill anyone.

For reciprocal compensation to apply, BellSouth would have to be the only carrier collecting revenue in this example. However, the exact opposite is occurring. ICG is the only carrier collecting revenue. So ICG's proposed arrangement is based on BellSouth collecting a revenue, when in fact we don't.

Now, compensation is, in fact, due for this traffic, but it is BellSouth instead of ICG who should be compensated. ICG is already compensated by the ISP.

Now the effect of applying reciprocal compensation to ISP-bound traffic is illustrated by Diagram G, which is what ICG is proposing. It is the same call, but what I have done is tried to identify the flows of revenues and calls. In this example, ICG would keep all of the revenue that the ISP pays them for the access service. BellSouth is not compensated for any of the cost that it incurs. And in addition to ICG keeping all of the revenues, BellSouth would pay ICG for some of its cost on the right-hand side of this tandem switch.

So ICG is recovering some of its cost twice, once from BellSouth and once from the ISP, and BellSouth doesn't recover any of it. In effect what this does is it sets up BellSouth subsidizing ICG's provision of this access service to these ISPs.

And finally what I would like to do is just describe the public policy impact of doing this. One, it reduces incentives for CLECs to serve residence and business end user customers. Residence and business end user customers are the ones that the ISPs will contact to buy service from. ISPs don't originate any traffic. All they do is terminate.

The more customers that you have that are ISP customers who are sending calls to the ISP under their proposal, the more reciprocal compensation you will pay. In addition to their collecting these revenues from the ISP, they collect an additional revenue stream from BellSouth to recover some of the same costs they are already recovering. It encourages an uneconomic preference for ALECs to serve ISPs. It increases the burden on end user customers. It is the end user customers who are funding these additional payments that are going to subsidize the ISPs.

It would even further discriminate among access users, that is IXCs versus ISPs. BellSouth would not be compensated for any of its costs incurred in this traffic. And lastly it creates incentives to arbitrage the system, and these are schemes that we have already seen go into place, wherein various types of carriers set up arrangements to essentially just generate reciprocal compensation mechanisms. We have already seen this happen.

Now, this Commission should determine that reciprocal compensation is not the appropriate interim intercarrier compensation mechanism. Should this Commission deem it necessary to act prior to the FCC's establishment of an intercarrier compensation mechanism, it should not be reciprocal compensation.

I'm trying to adjust this because of the part that was stricken, is where I am. So I guess the gist of BellSouth's proposal is that this issue is best left for the FCC to decide. They have said that they are going to decide it, and we believe that that is the appropriate thing to do. And in the interim ICG is not harmed. If anybody is harmed, it is BellSouth that is harmed.

So next I want to turn to the issue of the enhanced extended loop, or an EEL, as we have heard so much about. An EEL is a combination of loop and dedicated transport that connects a customer to an ALEC. As you know, the FCC recently decided on the list of UNEs that BellSouth must offer. They issued their press release. They haven't issued the order yet.

COMMISSIONER DEASON: Mr. Varner, you may want to slow down just a little bit.

THE WITNESS: Okay. However, whatever action this Commission takes must be consistent with the FCC's order when it does, in fact, become effective. And this Commission's arbitration will be decided some time in that time frame. So what I would like to do is to sort of describe where we think this matter stands at this point.

First and foremost, BellSouth is not obligated to combine UNEs. The FCC's rules that attempted to require BellSouth to do that were vacated by the Eighth Circuit. They were not challenged before the Supreme Court. Therefore, they are still vacated, and the FCC's 319 rule is not going to change that.

To provide EELs as requested by ICG, BelLSouth would have to combine UNEs. Since we are not obligated to perform this function, ICG's request should be denied for that reason alone. There is no facility that is currently in place that would connect a BellSouth customer to ICG's collocation space. If the customer is connected to ICG's collocation space, it is ICG's customer already. It is not BellSouth. So the facility that ICG is requesting must be created by BellSouth. It doesn't already exist.

Second, the FCC did not include an EEL in the list of UNEs that BellSouth must offer. When you look at the six that Ms. Schonhaut referred to, EEL is not on the list. They apparently considered it, decided not to put it on.

Third, ICG plans to use its EEL, which would contain UNE transport service, as a substitute for access. The extent to which UNE transport can be used to replace access service will be examined in another FCC proceeding. They said they were issuing a further notice of proposed rulemaking. In the interim, the extent to which UNE transport can be substituted for access should be addressed in the order when they issue it. So at this point it is not clear whether they can use UNE transport either by itself or in conjunction with the EEL in the manner that they have requested.

And the last point on this issue is that BellSouth must provide combinations of loops and transport only where they are currently combined. However, the definition of currently combined is not clear. Based on the FCC's action, we believe that the definition will be that the UNEs must already be in existence and providing service to a BellSouth end user when ICG requests them. That interpretation is correct. There are no currently combined UNEs that constitute an EEL. Therefore, ICG's claim that the EEL consists of currently combined UNEs is erroneous.

To sum up, BellSouth is not obligated to combine UNEs, which is required to provide the EEL. The extent to which ICG can use even individual UNEs as they are requesting is uncertain.

Now, given this environment, BellSouth recommends that this Commission simply rule that EELs will be provided to the extent required by law and FCC rules. The FCC and the courts are the only bodies that can resolve these questions, and until they are resolved, the prudent course is to simply obligate BellSouth to provide EELs in accordance with those FCC rules to make those decisions. We don't believe that it is necessary for the Commission to speculate about the outcome of those proceedings in order to resolve this issue.

The next area I would like to touch on is volume and term discounts for unbundled network elements or UNEs. And I would like to respond to ICG's claim that volume and term commitments --

MR. KRAMER: Excuse me, Commissioner, we have gone on at some length now. Well, over ten minutes since the break. Is there a time limit on these summaries?

COMMISSIONER DEASON: No, as long as he is covering material that is in his prefiled testimony, it is permissible. But, Mr. Varner, it has --

THE WITNESS: I'm getting close.

COMMISSIONER DEASON: Very good.

THE WITNESS: These last three are very brief. The volume and term discounts for UNEs, there is no obligation for us to do this under the act. Contrary to ICG's assertions, there are no cost savings that arise as a result of us doing this, there are no TELRIC costs that are saved, and there is no basis for offering them.

The next area or next to the last one is the appropriate application of reciprocal compensation. That is the issue of the tandem switching, and its issue centers on ICG's assertion that they are entitled to reciprocal compensation for functions that it does not perform. It does not perform the tandem switching function for local traffic, but regardless of that, they want to be compensated as if they did. And since they don't perform the function, they should not be. This Commission has previously addressed this in a previous proceeding and determined that is the appropriate course of action to take. We believe it should continue to do so.

The last issue is binding forecasts. Again, there is no obligation under the act for BellSouth to enter into binding forecasts, but nonetheless we have been analyzing this issue to see if we can offer such an arrangement as a voluntary offering, and we haven't yet completed that analysis. And that concludes my summary.

MR. KITCHINGS: Mr. Commissioner, I have nothing further of this witness at this time. He is now available for questioning.

COMMISSIONER DEASON: Thank you. You may proceed with your cross.

MR. KRAMER: Thank you.

(Transcript continues in sequence with Volume 4.)

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