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October 15, 1999

ORIGINAL

Ms. Blanca S. Bayó
Director, Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: UNE Docket No. 990649

Dear Ms. Bayó:

Enclosed for filing on behalf of Rhythms Links Inc. (f/k/a/ ACI Corp.)and Covad Communications Company are the original and fifteen copies of the surrebuttal testimony of Terry L. Murray.

By copy of this letter, these documents have been furnished to the parties on the attached service list.

Very truly yours,

Richard D. Melson

RDM/kcg
Enclosures
cc: Parties of Record

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Before the

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FLORIDA PUBLIC SERVICE COMMISSION

In re: Investigation into the pricing of unbundled network elements.	Docket No. 990649-TP

Surrebuttal Testimony

of

TERRY L. MURRAY

on behalf of

Covad Communications Company

and

Rhythms Links Inc.

October 15, 1999

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SURREBUTTAL TESTIMONY OF TERRY L. MURRAY ON BEHALF OF COVAD COMMUNICATIONS COMPANY AND RHYTHMS LINKS INC.

Q. Please state your name, title and business address.

A. My name is Terry L. Murray. I am President of the consulting firm Murray & Cratty, LLC. My business address is 227 Palm Drive, Piedmont, CA 94610.

Q. Have you previously filed testimony in this proceeding?

A. Yes, I have filed both direct testimony on behalf of Covad Communications Company ("Covad") and rebuttal testimony on behalf of both Covad and Rhythms Links Inc. ("Rhythms"). My direct and rebuttal testimonies placed particular emphasis on those issues that will affect the competitive offering of Digital Subscriber Line ("DSL") services. My direct testimony also provides a summary of my qualifications and experience.

I. INTRODUCTION AND OVERVIEW

Q. What is the purpose of your surrebuttal testimony?

A. My surrebuttal testimony responds to various issues raised in the rebuttal testimony of BellSouth witnesses Ms. Caldwell, Dr. Emmerson, Mr. Hendrix and Mr. Varner and GTE Florida, Inc. ("GTE") witnesses Mr. Doane, Mr. Trimble and Mr. Tucek.

Q. Please summarize your surrebuttal testimony.

A. In the remainder of my surrebuttal testimony, I will elaborate on the following points:

- The Commission should set nondiscriminatory, cost-based, deaveraged prices for the unbundled loops that new entrants will need to provide DSL-based services in competition with the incumbents. Contrary to the incumbents' claims on rebuttal, the incumbents' ability to provide DSL-based services on a "line-sharing" basis with POTS services gives them a significant competitive advantage in the provision of advanced services. The Commission should not compound this unfair advantage by denying new entrants nondiscriminatory access to unbundled loops at cost-based, deaveraged prices.
- The Commission should require the incumbents to provide rigorous and complete documentation for their cost studies. In particular, the Commission should require the incumbents to make available copies of any vendor contracts on which the cost studies rely and to provide adequate documentation of model code to facilitate sensitivity analyses. Without such requirements, analysis of the cost studies will be severely hampered and delayed.
- Because high non-recurring charges are a particularly severe barrier to competitive entry, the Commission should not brook any delay in obtaining up-to-date non-recurring cost studies that reflect non-

discriminatory access to efficient Operations Support Systems ("OSS") and a proper definition of non-recurring costs.

- Nor should the Commission permit BellSouth to impose an excessive and unnecessary "optional" non-recurring charge for order coordination, thereby creating an improper incentive for BellSouth to provide an inferior degree of cooperation to its competitors during a change of service.
- The Commission should reject the incumbents' attempts to link costing and pricing of unbundled network elements to retail pricing concerns. The appropriate form of "parity" is that both the incumbents and new entrants should have non-discriminatory access to network functionalities at cost-based input prices.
- The Commission should also reject the incumbents' attempts to delay this proceeding until either the implementation of either retail rate rebalancing or a universal service fund. To the extent that retail rate rebalancing and universal service concerns are legitimate, there are adequate mechanisms in place to address those concerns. This proceeding is the proper time and place to address *wholesale* pricing issues.
- Finally, the Commission should not prejudge the number of geographically deaveraged pricing zones. Only after examination of the cost studies can the Commission and the parties assess the

optimal tradeoff between pricing precision and administrative convenience.

II. THE COMMISSION SHOULD REQUIRE THE INCUMBENTS TO PRODUCE DEAVERAGED COST STUDIES FOR UNBUNDLED LOOPS THAT COMPETITORS CAN USE TO PROVIDE ADVANCED SERVICES SUCH AS DSL-BASED SERVICES.

Q. BellSouth witnesses Mr. Varner and Mr. Hendrix and GTE witness Mr. Trimble all take issue with your proposals to unbundle elements that competitors need to offer advanced DSL-based services. How much weight should the Commission give their criticisms of your unbundling proposals?

A. None. Mr. Varner and, to a lesser degree, Mr. Trimble have mischaracterized my proposals and responded to positions that I have not espoused. To the degree that they have created and knocked down strawmen, the Commission should disregard their testimony.

Moreover, the Federal Communications Commission ("FCC") has recently voted out an opinion on remand from the U.S. Supreme Court that redefines the unbundled network elements that incumbents must provide. Based on my reading of the FCC's press release concerning that order, it appears that the FCC has resolved the unbundling issues in dispute in this proceeding. Covad and Rhythms will discuss the implications of the FCC's

recent order in the supplemental rounds of testimony that this Commission has established for that purpose.

Q. At page 11 of his rebuttal testimony, BellSouth witness Mr. Varner objects to a proposal that he attributes to you "to unbundle network elements (*i.e.*, DSLAMs and packet switches) used in the provision of [BellSouth's] advanced services." Have you recommended that the Commission require the incumbents to unbundle these elements?

A. No, I have not. Mr. Varner has objected, without a specific citation to my direct testimony, to a proposal I never made. I have recommended that the Commission require BellSouth and other incumbents to unbundle the *loop* facilities that they use to provide advanced services such as DSL-based services. I have taken no position with respect to unbundling requirements for either DSLAMs or packet switches. I understand that the FCC's soon-to-be released order redefining unbundled network elements is expected to address the unbundling requirements, if any, for DSLAMs and packet switches. Therefore, I will defer any further discussion of this issue to the supplemental rounds of testimony concerning the new FCC unbundling requirements.

Q. Both Mr. Varner (at pages 12 and 13 of his rebuttal testimony) and GTE witness Mr. Trimble (at pages 21-24 of his rebuttal testimony) deny that incumbents have any advantage in the market for advanced

services. Do their rebuttal arguments respond directly to the analysis you presented in your direct testimony?

A. No. Both Mr. Varner and Mr. Trimble have distorted my direct testimony in an attempt to create a false impression concerning their companies' competitive advantages in the provisioning of DSL-based services. It is one thing to say (as I did, correctly, in my direct testimony) that the incumbent local exchange carriers did not begin the competitive era with near-monopoly market shares for DSL-based services. It is quite another to say (as Mr. Varner and Mr. Trimble do, incorrectly, in their rebuttal testimonies) that the incumbents have no special advantages in providing DSL-based services.

The BellSouth and GTE witnesses improperly rely on snapshot comparisons of DSLAMs or other DSL-related equipment deployed by competitors versus incumbents as proof that they lack any special competitive advantages. *See, for example,* Varner Rebuttal at 12; Trimble Rebuttal at 23-24. Such comparisons are meaningless because it is too soon to measure the success of the incumbents' active marketing of DSL-based services, especially to residential customers.

The incumbents generally did not offer DSL-based services (other than certain T-1 services that used DSL technology) prior to the passage of the Telecommunications Act of 1996 ("Act"). Indeed, as the Pennsylvania Public Utility Commission recently observed, incumbent local exchange carriers did not begin rolling out their DSL-based services until forced to

do so by the pressure of competitors such as Covad and Rhythms. *See Joint Petition of Nextlink Pennsylvania, Inc.; Senator Vincent J. Fumo; Senator Roger Madigan; Senator Mary Jo White; the City of Philadelphia; The Pennsylvania Cable & Telecommunications Association; RCN Telecommunications Services of Pennsylvania, Inc.; Hyperion Telecommunications, Inc.; ATX Telecommunications; CTSI, Inc.; MCI Worldcom; and AT&T Communications of Pennsylvania, Inc. for Adoption of Partial Settlement Resolving Pending Telecommunications Issues*, Pennsylvania Public Utility Commission Docket No. P-00991648, and *Joint Petition of Bell Atlantic Pennsylvania, Inc., Conectiv Communications, Inc.; Network Access Solutions; and the Rural Telephone Company Coalition for Resolution of Global Telecommunications Proceedings*, Pennsylvania Public Utility Commission Docket No. P-00991649, Opinion and Order (rel. September 30, 1999) at 108.

Despite their slow start, the incumbents have at least one tremendous competitive advantage that Mr. Varner and Mr. Trimble chose to ignore: their discriminatory ability to "line-share." Both BellSouth and GTE provide DSL-based services over the same loop that they use to provide voice-grade services to retail customers, but utilizing different frequencies to transport voice and data over that loop. Neither company allows competing providers of DSL-based services to offer a comparable line-sharing option to the incumbent's POTS customers. As I explained in

both my direct and rebuttal testimonies, this distinction enables the incumbents to leverage their dominance in the provision of voice-grade services to gain a competitive advantage in the provision of advanced services.

The FCC's recent decision in the SBC-Ameritech merger proceeding recognizes the enormous competitive advantage that line-sharing confers on incumbents such as BellSouth and GTE. As a condition of merger approval, the FCC is requiring the merged company to offer a surrogate line-sharing discount of 50% off both the recurring and nonrecurring charges that would otherwise apply when a competitor orders an unbundled loop to provide DSL-based services to a retail customer that obtains voice-grade services from the incumbent. This discount applies unless and until the merged company provides nondiscriminatory line-sharing to nonaffiliated providers of DSL-based services. *See In re Applications of Ameritech Corp., and SBC Communications Inc., Transferee, for Consent to Transfer Control of Corporations Holding Commission Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95 and 101 of the Commission's Rules*, CC Docket No. 98-141, Memorandum Opinion and Order (rel. October 8, 1999) at ¶¶ 379-380.

Let me be clear. I am not recommending that this Commission take action on the line-sharing issue in this proceeding. Instead, I am pointing out that incumbents such as BellSouth and GTE already have a significant

advantage in the provision of DSL-based services. The most important step for this Commission to take now is to ensure that the costing and pricing of unbundled loops in Florida does not provide a further unfair advantage to the incumbents. At a minimum, fairness requires that competitors have nondiscriminatory access to unbundled loops for DSL-based services at prices based on forward-looking economic costs. Moreover, because the cost of such loops varies significantly across geographic areas, nondiscriminatory prices must reflect geographically deaveraged costs.

III. THE COMMISSION SHOULD REQUIRE DETAILED COST STUDY DOCUMENTATION.

Q. At pages 18-19 of her rebuttal testimony, BellSouth witness Ms. Caldwell suggests that your recommended cost study documentation standards are unreasonable, unnecessary or both. Is Ms. Caldwell correct?

A. No. Ms. Caldwell is merely expressing the incumbent's desire to eat its cake and have it too. BellSouth has repeatedly insisted that the Commission must rely on its company-specific "actual" cost data to determine prices for unbundled network elements. Yet BellSouth now resists any Commission-imposed requirement to provide interested parties with the documentation that those parties would need to test the validity of its alleged "actual" costs.

The decision to permit BellSouth and other incumbents to submit cost studies reflecting the incumbents' proprietary internal practices and data, as opposed to an open model using public data sources, has a subtle yet strong effect on the final determination of costs. The Commission cannot explicitly determine every single assumption, algorithm and input that makes up a cost study. Yet whenever the Commission does not explicitly address an issue, it implicitly decides that issue in favor of the default assumption of the adopted cost model. Thus, once the Commission decides to use the incumbents' proprietary cost studies as a basis for setting prices, the practical burden of proof falls on other parties to find and substantiate flaws in the incumbents' analyses.

Parties cannot even begin to meet this burden without access to the proprietary data on which the incumbents have supposedly based their studies. Making parties extract the relevant data via discovery will at best cause unnecessary delay and at worst prevent the parties from having a meaningful opportunity to challenge the incumbents' assertions.

To create a more balanced opportunity for all parties to present their analysis of the incumbents' claimed costs, the Commission should require the incumbents to make the supporting documentation for their cost studies available at the time that they submit their cost studies. Providing the necessary documentation should be a straightforward task: after all, the incumbents will presumably have had to access that material to develop their cost studies. Therefore, the Commission should presume that

any assumption, algorithm or input for which an incumbent cannot produce support at the time of its cost filing has no supporting basis in the incumbent's "actual" operations. Other parties have a sufficient burden trying to analyze the cost study material itself without an additional handicap of not having access to the supposed underlying facts.

Q. Does your previous answer mean that you agree with Ms. Caldwell that the cost studies should only reflect "BellSouth-specific" (or, more generally, company-specific) inputs and assumptions?

A. No. I disagree with both Ms. Caldwell, who argues extensively at pages 4-7 and 11 of her rebuttal testimony in favor of BellSouth-specific inputs, and with BellSouth witness Dr. Emmerson, who argues at page 3 of his rebuttal testimony for some sort of "transitional" assumption with respect to central office sizing. The proper standard for forward-looking costs is not what BellSouth (or any other incumbent) *plans* to deploy at some future date, or what it will deploy during a *transition* from embedded costs to efficient, long-run costs. Instead, the proper standard is what BellSouth *could achieve* — given the location and size of the demand it faces, the location of its wire centers, and the specific geography of its service territory — if it were to deploy commercially available technology in the most efficient manner possible. That is the standard that the FCC's Total Element Long Run Incremental Cost ("TELRIC") methodology requires.

To test how well BellSouth's cost studies meet this standard, parties will need access to the specific details of any BellSouth internal data and documents on which the company relies. Otherwise, the record will be unclear as to whether claimed company-specific costs are truly the lowest, most efficient costs that BellSouth can achieve in the long run or merely the outcome of some interim, inefficient process.

Q. At page 10 of her rebuttal testimony, Ms. Caldwell provides three reasons for her belief that the Commission should not require BellSouth to produce all of the contracts that underlie its input prices when BellSouth files its cost study. Are Ms. Caldwell's reasons compelling?

A. No. Ms. Caldwell's first concern is the possibility of inappropriate release of BellSouth's proprietary data. To the extent that the contracts contain information that is truly proprietary, the appropriate and longstanding solution to Ms. Caldwell's concern is to require parties receiving the data to execute and abide by a protective agreement. She provides no reason to believe this traditional measure would be insufficient to protect the legitimate business interests of BellSouth and its vendors. GTE witness Mr. Tucek has indicated that his company intends to provide precisely such contract data pursuant to a "satisfactory proprietary agreement." *See* Tucek Rebuttal at 8.

Ms. Caldwell's second and third concerns are the possible harm to BellSouth if parties were to use its data out of context or ignore relevant caveats and limitations in BellSouth's contracts. BellSouth will have ample opportunity to point out any such misuse in its rebuttal testimony and cross-examination, thus resolving these concerns.

The more serious risk is that, without a requirement to produce its contracts for inspection, BellSouth would be able to base its cost study assumptions on its own out-of-context contract interpretations or to ignore significant contract terms. All parties need access to BellSouth's contracts so that they can identify to the Commission any instances in which their interpretation of the contract terms differs from that of BellSouth and thus highlight BellSouth's possible misuse of its contract data.

Q. At pages 7-8 of his rebuttal testimony, GTE witness Mr. Tucek describes the cost documentation that GTE proposes to provide. Is his proposed documentation adequate to meet the Commission's and the parties' needs?

A. Mr. Tucek's summary description appears to address many of requirements that I had proposed in my direct testimony. Specifically, he states GTE's intention to provide both electronic and hard-copy versions of its cost filing in a manner that will enable parties to examine the actual model code, to reproduce the company's filing and to conduct sensitivity analyses. He also states the company's intention to provide documentation of the

development and sources of its material and placement inputs, including relevant contracts, plus supporting documents relating to its engineering practices, labor and materials loadings and runs of the SCIS and CostMod models.

Based on his description, I do have some outstanding concerns. First, where GTE performs miscellaneous cost studies outside its "main model," it appears that the company will be making less information concerning the models available than GTE proposes to supply for its "main model." To the extent that this difference hampers the ability of parties to verify some of GTE's results or to perform sensitivity analyses, the Commission should not permit GTE to provide an inferior level of documentation and support for so-called "miscellaneous" cost studies.

Second, my prior experience with GTE's Integrated Cost Model suggests that there may be a need for parties to perform sensitivity analyses on variables that are "hard-wired" into the model code. Thus, I would recommend that the Commission require all of the incumbents to provide sufficient documentation for their cost models, including documentation of the source code, so that it is readily apparent how one would test the sensitivity of the model results to varying parameter values.

Third, GTE proposes to provide investment data at the individual wire center level. To develop deaveraged prices, however, parties will need all costs — investments and expenses — stated on the same

deaveraged basis. It is unclear whether the data GTE intends to provide will meet this need.

IV. THE COMMISSION SHOULD REQUIRE THE INCUMBENTS TO SUBMIT STUDIES OF BOTH RECURRING AND NON-RECURRING COSTS, PROPERLY DEFINED, IN PHASE II OF THIS PROCEEDING.

Q. At page 19 of his rebuttal testimony, GTE witness Mr. Trimble reiterates his recommendation that the Commission should defer any consideration of non-recurring charges until the conclusion of the parallel docket addressing OSS issues. Does his elaboration on this theme provide any new reason for the Commission to tolerate such a delay?

A. No, it does not. Mr. Trimble's claim that the incumbents cannot be expected to study non-recurring costs until the Commission has established final OSS requirements and performance measures is unfounded. In fact, GTE's cost study developers have elsewhere admitted that they do not need to know the specifics of forward-looking interfaces and planned OSS enhancements to understand the effect of those improvements on GTE's non-recurring costs. *See* November 6, 1998, deposition of GTE witness Mr. Rodney Langley, Tr. at 83-85, in California Public Utilities Commission dockets R.93-04-003, *Rulemaking on the Commission's Own Motion to Govern Open Access to Bottleneck Services and Establish a*

Framework for Network Architecture Development of Dominant Carrier Networks, and I.93-04-002, *Investigation on the Commission's Own Motion into Open Access and Network Architecture Development of Dominant Carrier Networks*.

Furthermore, to the extent it has any relevance at all, Mr. Trimble's argument applies primarily to pre-ordering and ordering charges. OSS requirements and performance measures have little conceivable application to the non-recurring costs for functions such as installation and loop "de-conditioning." Instead, these non-recurring costs depend primarily on assumptions about forward-looking network design. The biggest challenge to getting these costs right is to impose tight coordination between the recurring and non-recurring cost studies (particularly for loops). Without such coordination, there is a good chance that the incumbents' non-recurring costs for installation and "de-conditioning" will double-count costs already reflected in their recurring cost studies.

There is no valid reason for delay and every reason for the Commission to consider recurring and non-recurring costs in the same proceeding. Therefore, I recommend that the Commission reject Mr. Trimble's proposal.

Q. At page 12 of her rebuttal testimony, BellSouth witness Ms. Caldwell states that "from a cost methodology perspective, costs should be stated as they naturally occur, *i.e.*, if the costs are one-time expenses it

is appropriate to express them as nonrecurring." Is this the definition of non-recurring costs that should govern the incumbents' Phase II submissions?

A. No. Ms. Caldwell's definition does not provide a distinction between recurring and non-recurring costs that would enable the Commission to establish appropriate prices that reflect cost causation.

Some "one-time expenses" are properly treated as non-recurring costs and recovered from the customer on whose behalf they are incurred. For example, the cost of processing a particular customer's service order is a one-time expense that is appropriately treated as a non-recurring cost and recovered from that customer. Once incurred, the service order cost does not have any enduring value. The incumbent cannot reuse the time spent processing that order to process any subsequent service order.

Other "one-time expenses" are more appropriately treated as recurring costs, however, and recovered over time through recurring charges. Consider, for example, the cost of installing a new drop. This installation cost could be considered a one-time expense, yet the drop will have a long economic life and subsequent customers at that same location will reuse the drop. In other words, the cost is location-specific, not customer-specific, and should be recovered over time from all customers at that location.

Q. What would be a better definition of "non-recurring costs"?

A. The Commission should define non-recurring costs as "customer-specific one-time expenses associated with installing or disconnecting a service." This definition would create a distinction between recurring and non-recurring costs that would be useful for subsequent pricing decisions.

Q. Why is it important that the incumbents' cost studies properly distinguish between recurring and non-recurring costs?

A. High non-recurring charges inherently deter competitive entry because they impose sunk costs that a new entrant cannot avoid or recover if it exits the market. Thus, it is essential that the non-recurring charges associated with unbundled network elements reflect only those costs that are truly non-recurring.

Q. At page 14 of her rebuttal testimony, Ms. Caldwell defends BellSouth's proposed order coordination cost for optional "coordination above-and-beyond the norm." Should the Commission authorize an "optional" non-recurring charge for order coordination?

A. No, unless BellSouth can demonstrate that there is some desired level of coordination that exceeds a *reasonable* "norm." To promote high quality service in Florida, the Commission should establish as a policy "norm" for both retail and wholesale operations the expectation that all carriers will automatically engage in sufficient coordination of connection and disconnection activities to minimize any interruption in service to the end-user customer. Each carrier should bear its own costs of accomplishing

that degree of coordination as part of the normal process of providing quality customer service in a competitive environment.

This "norm" is not a new requirement. BellSouth and other incumbent local exchange carriers generally have in place retail order processing systems that can automatically coordinate orders so as to minimize the length of time that an end-user is out of service. That practice (*i.e.*, coordinating activities so as to minimize service interruption) is typically reflected in the baseline cost of the end-user's retail service, rather recovered through an additional charge when an end user is changing or moving service. In other words, BellSouth's retail customers have already "prepaid" for a high degree of coordination between the disconnection of their existing retail service and the connection of any substitute service.

There is no sound public policy reason for BellSouth to treat coordination with a new entrant any differently from its internal coordination when switching a customer from one service to another. To provide comparable service to new entrants, the Commission should expect incumbents to build any necessary coordination into its process in a mechanized and efficient manner. Without that presumption, an "optional" coordination charge could become all too similar to the "protection" payment that the local mob boss demands of small businesses. If the new entrant does not wish to risk a service outage for its new customer, it will have no choice but to purchase "coordination insurance" to ensure that the

incumbent will cooperate with the transition of retail service to the new entrant.

If BellSouth can establish that its proposed optional coordination charge reflects only the incremental cost for some extraordinary level of coordination beyond the standard of automated coordination I have just defined, then the Commission may wish to consider such a charge. The Commission should not even consider any coordination charges, however, unless and until BellSouth demonstrates that its assumed "norm" reflects every reasonable effort to provide automated coordination of service cutovers.

V. THE COMMISSION SHOULD NOT LINK WHOLESALE DEAVERAGING TO RETAIL PRICING CONCERNS.

Q. Several witnesses for BellSouth and GTE raised points in their rebuttal testimonies about the alleged need for a linkage between retail pricing and wholesale deaveraging. Should the structure of the incumbents' retail prices play any role in determining the nature and degree of deaveraging for the prices of unbundled network elements?

A. No, it should not. Consistent with § 251(d)(1) of the Act, the Commission should apply only two standards to determine the pricing of unbundled network elements: that is, the prices should be cost-based and nondiscriminatory. As I explained in my rebuttal testimony, the Act's nondiscrimination standard implies that the price of an unbundled network

element to a competitor should be the same as the effective price that the incumbent faces for the use of that same functionality in its network.

The effective input price that the incumbent faces for use of its network functionalities is the forward-looking economic cost of those functionalities. Moreover, that effective input price reflects geographic variations in costs (the forward-looking economic cost of the network elements) regardless of whether the incumbent's retail prices are deaveraged. Therefore, uniform statewide prices for unbundled network elements are discriminatory where the underlying costs to the incumbent exhibit strong geographic variations, contrary to the claims of BellSouth witness Mr. Hendrix at pages 4-5 of his rebuttal testimony. The Commission should adopt deaveraged costs and prices for unbundled network elements that reflect significant variations in the forward-looking economic cost of those elements to the incumbent.

Q. Your direct testimony indicated that the Commission should consider "parity" between the incumbents' retail pricing of DSL-based services and the wholesale pricing of the loops that competitors must purchase to offer their own DSL-based services. GTE witnesses Mr. Trimble and Mr. Doane both cite this testimony as support for their position concerning the proper relationship of retail and wholesale prices. *See* Trimble Rebuttal at 15; Doane Rebuttal at 8-9. Is your position the same as theirs?

A. No, it is not. My goal is to ensure that the incumbent charges its competitors the same price for unbundled DSL-capable loops as the incumbent in effect charges itself when it provides retail DSL-based services. Thus, the "parity" issue that I raised in my direct testimony is simply an application of the nondiscrimination requirement of the Act. Indeed, I made this equivalence clear at page 8 of my direct testimony, a passage that Mr. Doane cites. *See* Doane Rebuttal at 8.

As I explained in my previous answer, the normal and most straightforward economic interpretation of a nondiscrimination or "parity" requirement would be to set geographically deaveraged prices for unbundled DSL-capable loops that reflect the underlying variations in the incumbents' forward-looking economic cost of providing those loops. Thus, contrary to Mr. Doane's rebuttal testimony at page 8, there is no contradiction between my position on parity and my advocacy of TELRIC-based prices.

There is, however, a unique problem in applying the normal economic interpretation of nondiscrimination to the pricing of unbundled DSL-capable loops. That problem arises because the incumbents provide retail DSL-based services via a line-sharing arrangement that they do not make available to competitors on a nondiscriminatory basis. The effect of this line-sharing arrangement is that the incumbents recover all of their loop costs from the POTS service and exclude those loop costs from the calculation of the retail price floor for the DSL-based services. As I

explained in Section II of this surrebuttal testimony, the FCC's decision in the SBC-Ameritech merger proceeding has recognized the need to depart from strict TELRIC-based pricing of unbundled DSL-capable loops as a means of restoring competitive balance in the provision of DSL-based services.

Q. Several BellSouth and GTE witnesses specifically assert in their rebuttal testimony that wholesale deaveraging in the absence of retail rate rebalancing will encourage inefficient entry in urban areas. (*See, e.g.*, Trimble Rebuttal at 12; Emmerson Rebuttal at 6-7.) Is this a valid concern?

A. No. As I explained in my rebuttal testimony, BellSouth and GTE both have elected to operate under the price regulation scheme adopted by the Florida legislature in 1995. A key feature of that price regulation scheme is the ability of the incumbents to reduce retail prices that exceed costs. Thus, both companies have the power to meet competition and deter inefficient entry without Commission action on retail rate rebalancing. Moreover, the existing Florida price regulation scheme already provides BellSouth and GTE with some upward pricing flexibility for non-basic services; thereby, they can accomplish a degree of rate rebalancing without any Commission intervention whatsoever.

The incumbents' attempt to link wholesale deaveraging to retail rate rebalancing is thus a red herring whose main effect is to create

competition-inhibiting delay. The incumbents may indeed desire to finance competition-driven retail price reductions through offsetting increases in prices for *basic* services that they expect to face less competitive pressure. There is no sound public policy basis for delaying the introduction of geographically deaveraged wholesale prices simply as a means of preserving the incumbents' existing revenue streams.

Q. BellSouth witness Dr. Emmerson discusses the flip side of this concern, that is, the risk that geographically deaveraged prices for unbundled elements will shut efficient entrants out of the market where retail prices remain averaged and the average statewide price is below the deaveraged regional cost. *See* Emmerson Rebuttal at 6-7. Should this concern cause the Commission to delay deaveraging of unbundled network elements until it has examined retail rate rebalancing?

A. No, it should not. If anything, Dr. Emmerson's argument illustrates the urgent need for the Commission to obtain appropriately deaveraged *cost* data, so that the parties can identify the potential magnitude of this problem and determine what, if any, action is needed.

Deaveraged prices for unbundled network elements need not, however, lead to deaveraged retail prices. Ultimately, the establishment of a competitively neutral universal service funding mechanism should enable

purchasers of unbundled loops in high-cost areas to compete even with a statewide-average retail price.

Q. Do you then agree with BellSouth witness Mr. Varner, who stated at page 2 of his rebuttal testimony that the Commission should put off deaveraging until a universal service fund is in place?

A. No. My rebuttal testimony discussed the means that the incumbents already have, under Florida precedent, to address any legitimate universal service concerns; I will not duplicate that discussion here. I wish to emphasize, however, that the Commission should continue on schedule with this proceeding so that it can adopt deaveraged prices for unbundled loops no later than the date that the FCC is ready to implement a federal universal service fund. The lead-time needed to determine deaveraged costs and prices is simply too long to make further delay a reasonable option.

VI. THE COMMISSION SHOULD NOT PREJUDGE THE OPTIMAL NUMBER OF ZONES FOR DEAVERAGING.

Q. At pages 3-4 of his rebuttal testimony, BellSouth witness Mr. Hendrix reiterates the company's preliminary proposal to rely on a "local market precedent" and establish two pricing zones. Does his discussion present any new or compelling reason for the Commission to adopt the BellSouth proposal at this time?

A. No. As I have already explained in my rebuttal testimony, BellSouth's reliance on retail market precedent has almost no value in determining the appropriate definition of geographic zones for deaveraging unbundled network elements. There is no record evidence to support the view that BellSouth's retail pricing zones bear any systematic resemblance to the cost variations that should be the primary determinant of geographically deaveraged pricing for unbundled network elements.

Q. At page 6 of his rebuttal testimony, Mr. Hendrix complains that ten zones would create an unreasonable administrative burden on BellSouth. Should the Commission rule out the possibility of establishing as many as ten zones for deaveraged pricing?

A. No, not at this time. I agree with the premise that there is a tradeoff between the precision with which geographically deaveraged prices match costs and the administrative convenience of minimizing the number of pricing zones. Without knowing precisely how costs vary, however, I cannot determine — and certainly Mr. Hendrix has not shown — whether the inconvenience to BellSouth of managing the billing process for as many as ten pricing zones would outweigh the additional precision gained from so many zones. I do note, however, that the incumbents seem to have varying opinions as to the optimal number of zones. I suggest that the Commission make no determination as to the number of pricing zones until

it has had an opportunity to review the cost evidence and reach its own conclusions concerning this tradeoff.

Q. Does that conclude your testimony at this time?

A. Yes, it does.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing was furnished to the following parties by U.S. Mail this 15th day of October, 1999.

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