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REBUTTAL TESTIMONY OF NINA W. CORNELL

ON BEHALF OF MCI

DOCKET NO. 960846-TP

September 16, 1996

~~960846-TP~~ 960833 TP

Q. WHAT IS YOUR NAME AND ADDRESS?

A. My name is Nina W. Cornell. My address is 1290 Wood River Road, Meeteetse, Wyoming 82433.

Q. HAVE YOU FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony responds to the direct testimony of Dr. Emmerson and Mr. Milner, filed on behalf of BellSouth Telecommunications, Inc. ("BellSouth").

Q. WOULD YOU PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY?

A. Yes. Dr. Emmerson is incorrect to claim that MCI has asked for unbundled network element and interconnection prices at total service long run incremental costs, so all of his arguments about the possible inefficiencies of doing so should be ignored. Dr. Emmerson has also argued that incumbent local exchange carriers have higher relative

1 shared costs than entrants. These arguments are both untrue, and irrelevant to pricing
2 unbundled network elements and interconnection. Dr. Emmerson implies that the
3 additional costs BellSouth should be able to recover in the prices for unbundled
4 network elements and interconnection should be based on its revenue requirement.
5 This should be rejected because it would prevent consumers from getting the greatest
6 possible benefits from entry and competition. Dr. Emmerson also asks that the markup
7 over direct economic cost to recover any shared costs that should be recovered from
8 unbundled network elements and interconnection should be done based on demand
9 conditions. This would be entry-impeding, and should be denied.

10 Mr. Milner claims that a number of unbundled network elements are not
11 technically feasible to provide. Mr. Milner has redefined technical feasibility to
12 include both considerations of cost and to omit any possible changes to the current
13 BellSouth network. This is contrary to the decision of the Federal Communications
14 Commission (FCC), and would allow BellSouth to deny entrants the ability to use
15 unbundled network elements, contrary to the Telecommunications Act of 1996 (the
16 Act). He also claims that BellSouth cannot provide the unbundled switching element
17 as defined by the FCC. As a result, he would impose dialing disparities on entrants,
18 contrary to the Act. The Commission should reject Mr. Milner's claims of technical
19 infeasibility, and order BellSouth to provide all of the requested unbundled network
20 elements.

21

22 Q. DR. EMMERSON DISCUSSES TOTAL SERVICE LONG RUN INCREMENTAL
23 COSTS (TSLRIC) AT THE BEGINNING OF HIS TESTIMONY. IS MCI ASKING
24 FOR RATES FOR UNBUNDLED NETWORK ELEMENTS TO BE SET AT
25 TSLRIC?

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A. No. MCI is asking that rates be set using the results of the Hatfield model, which produces estimates of the total element long run incremental cost (TELRIC) and also include shared costs and some of the costs frequently categorized as common costs for a wholesale-only firm. As Dr. Emmerson notes later in his testimony, TELRIC costs are estimated using different cost objects than services. TELRIC costs are, however, a form of TSLRIC costs, simply with the total quantity of *network elements* as the cost object, rather than the various *services* provided using those network elements.

Because MCI is not asking that rates for unbundled network elements be set just at TSLRIC or TELRIC, my testimony does not respond to those points in Dr. Emmerson's testimony that flow from his erroneous claim that MCI has asked for prices to be set equal to TSLRIC or TELRIC.

Q. DR. EMMERSON OFFERS A NUMBER OF REASONS WHY HE BELIEVES INCUMBENT LOCAL EXCHANGE CARRIERS WILL HAVE A HIGHER PROPORTION OF SHARED COSTS THAN ENTRANTS. DO YOU AGREE WITH HIS ARGUMENTS?

A. No. According to Dr. Emmerson:

There are several factors which I believe will cause a LEC, like BellSouth, to tend to have a higher proportion of shared costs than other competing firms. These factors include: 1) a large number of services offered; 2) network-based provider; 3) a franchise obligation to provide ubiquitous service over broad geographic areas; 4) large scale and lumpy investment characteristics; 5) predominantly producing

1 services rather than products; and 6) "leasing" virtually no unbundled
2 components from other providers. (Emmerson Direct, page 5, lines
3 18-24)

4 With one possible—but not certain—exception, none of his claims are valid. His first
5 and fifth claims apply equally to incumbents and entrants alike. His second and fourth
6 claims apply equally to all entrants that build at least part of their own networks. His
7 third claim may be the exception, but it can only be valid if Dr. Emmerson believes
8 the loop is a shared cost, and even then it may not be accurate. His sixth claim is
9 simply untrue. Moreover, his discussion is largely irrelevant to a wholesale-only firm
10 providing unbundled network elements, which is the correct standard to apply.

11

12 Q. WHY DO HIS FIRST AND FIFTH CLAIMS APPLY EQUALLY TO ENTRANTS
13 AND INCUMBENTS ALIKE?

14

15 A. Entrants will be forced to offer a large number of services if they want to win
16 customers. Many of the services offered by an incumbent local exchange carrier are
17 taken by a given customer. Thus, many local exchange customers also subscribe to
18 call-waiting, or call-forwarding services, to intraLATA toll service, perhaps even to
19 a discount intraLATA toll offering, and the like. Entrants will have to match the array
20 of services to be able to win customers. Thus, not only will entrants be offering a
21 similarly large number of services, but they will be producing primarily services, not
22 products.

23

24 Q. WHY DO DR. EMMERSON'S SECOND AND FOURTH CLAIMS APPLY
25 EQUALLY TO ENTRANTS THAT BUILD AT LEAST SOME NETWORK OF

1 **THEIR OWN?**

2

3 **A. An entrant that builds at least part of its own network, for example, a fiber-ring**
4 **provider, will also be a network-based provider. That provider will have “lumpy”**
5 **investment characteristics like those facing the incumbent local exchange provider.**
6 **“Lumpy” investments are investments that cannot be made necessarily in just the**
7 **desired size, or be added to with just the amount of additional capacity needed. If**
8 **there is a minimum size, or if expansion units come only in a few sizes, the investment**
9 **is “lumpy.”**

10 **A carrier builds a local network using equipment that is available from**
11 **equipment suppliers. The same equipment suppliers are providing equipment to**
12 **entrants and incumbents alike. Thus, the equipment available to entrants is just as**
13 **“lumpy” as the equipment incumbents can buy.**

14

15 **Q. WHY DO YOU SAY THAT THE FRANCHISE OBLIGATION DOES NOT MEAN**
16 **A HIGHER PROPORTION OF SHARED COSTS UNLESS DR. EMMERSON**
17 **AGREES THAT THE LOCAL LOOP IS A SHARED COST AND EVEN THEN**
18 **MAY NOT BE VALID?**

19

20 **A. To understand the potential fallacy in this claim, it is necessary to look at how local**
21 **networks are constructed. A carrier will place a switch and loop plant to connect its**
22 **customers to the switch. Once there are sufficient customers in a local area, the**
23 **carrier will place a second switch, and interoffice plant to connect the two. In essence,**
24 **each separate switch starts all over again the process of accumulating shared plant.**
25 **The only way in which adding a second switch increases the proportional amount of**

1 shared costs is when the interoffice trunks share structure costs with loop plant.

2 Thus, the fact that incumbent local exchange carriers serve broad geographic
3 areas is irrelevant to the relative proportions of shared plant because different
4 communities are separate local exchanges with their own switches and loop plant. The
5 major distinction is that in some exchanges, loops are longer because the community
6 is less dense, needing only a single switch. Thus, the only way that serving a broader
7 geographic area may—but is not certain to—lead to any significant increase in the
8 relative proportion of shared costs is if the local loop is a shared cost.

9 Whether the local loop is a shared cost depends upon what are the cost objects
10 of the firm. When the total costs of the network of the firm are determined on the
11 basis of unbundled network elements, the local loop is not a shared cost. When the
12 cost objects are services such as local exchange service, toll service, switched access
13 services, and the like, the loop is a shared cost.

14 If the cost objects are traditional services, in which case the local loop is a
15 shared cost, serving rural areas *might* mean higher proportional shared costs for
16 incumbents than for entrants. This is only a possibility, however, because entrants
17 with their own facilities have longer loops in the urban areas than do the incumbents.
18 As a result, this claim *might* be valid, but only if the cost objects of the firm are
19 traditional services, in which case local loops should be considered part of shared costs
20 *and* only if the rural loops of the incumbents are longer than the loops of the entrants
21 in urban areas.

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23 Q. WHY IS DR. EMMERSON WRONG WHEN HE CLAIMS THAT WHEN A
24 CARRIER LEASES COMPONENTS, THE PRICES PAID BECOME DIRECT
25 INCREMENTAL COSTS OF SERVICES WRONG?

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A. This claim is wrong because the choice between “leasing” an input and building it does not change whether the cost of the input is a shared cost or a direct incremental cost. If an entrant leases loops, but offers its customers a substitute for traditional local exchange service and intraLATA toll service, and offers interexchange carriers switched access service, the loop will continue to be a shared cost of all of those services despite its being “leased” and not built by the entrant. The question of what is a shared cost and what is not does not depend primarily on whether inputs are built or leased, but on what are the cost objects of the firm when categorizing costs as direct or shared.

Q. IS DR. EMMERSON’S EXAMPLE OF SWITCHED ACCESS BEING 60% OF AT&T’S TOLL REVENUES RELEVANT TO WHETHER LEASING OR BUILDING ALTERS THE NATURE OF THE COST?

A. No. AT&T’s experience with switched access as a proportion of its total revenues is not relevant to whether leasing facilities changes shared costs into direct costs. Switched access is charged on a per minute basis. Because it is charged on a per minute basis, it becomes a direct cost for each toll service that uses switched access. Moreover, if AT&T had built the facilities to provide switched access for itself, assuming that were possible, most of the cost of the switching and transport would continue to be direct costs, as they are caused by minutes of use, or minutes of use at peak. Only the loop plant would be a shared cost unless AT&T had only used the loops for switched access purposes. The loops provided by the incumbent local exchange providers are shared costs of the various services that use them, just as they

1 would have been for AT&T.

2

3 Q. YOU SAID EARLIER THAT DR. EMMERSON'S CLAIMS ABOUT SHARED
4 COSTS OF INCUMBENT LOCAL EXCHANGE CARRIERS BEING HIGHER
5 THAN THE SHARED COSTS OF ITS COMPETITORS IS IRRELEVANT TO A
6 WHOLESALE-ONLY FIRM PROVIDING UNBUNDLED NETWORK ELEMENTS.
7 WHY IS THIS THE CORRECT STARTING POINT FOR AN ANALYSIS OF
8 SHARED COSTS TO BE RECOVERED IN THE RATES FOR UNBUNDLED
9 NETWORK ELEMENTS?

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11 A. It is very important that any costs that are shared be collected in the rates from the
12 items that share those costs, and *only* those items. Otherwise, the items that share the
13 costs will be receiving a cross subsidy, which is both inefficient and bad for
14 consumers.

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Unbundled network elements are wholesale offerings. They should pay no more than the costs of a wholesale-only firm, because they are not part of retail offerings. If the costs of a wholesale-only firm are calculated, they may include costs that would be shared between both retail and wholesale services, but should not include any costs that are shared only among retail services. Including costs that would be shared between retail and wholesale services in essence turns the costing exercise into an attempt to estimate the stand-alone costs of a wholesale-only firm. The test for whether a price provides a cross subsidy is whether it is above the stand-alone cost of the item. So long as prices for unbundled network elements recover no more than the per-unit stand-alone costs of a wholesale-only firm, unbundled network elements will not be providing a cross subsidy.

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Q. DR. EMMERSON CLAIMS THAT THE GREATER THE EFFICIENCIES OF SHARING FACILITIES AND COSTS, THE GREATER WILL BE THE NEED TO SET PRICES ABOVE TELRIC. DO YOU AGREE?

A. Not necessarily. Shared costs and shared facilities are not the same concepts, but can easily be confused.

“Shared plant” refers to specific items of equipment that are used to provide more than one service. Plant may be shared among services, but have all of its costs *caused* by each of those services individually, if additional units of any one of the services cause the shared plant to be larger than it would otherwise be or in some other manner cost more than it otherwise would. Take the example of a tandem switch. Much of the cost of the switch is determined by—and varies with—the peak period calls of different kinds that the tandem processes. Thus, although the tandem switch is an example of a piece of shared *plant*, most of its cost is *not* a shared *cost*. The same is true of almost all other elements of a local exchange network. Different usage services share interoffice trunking plant, but a significant amount of the cost of that plant varies depending upon the total peak period usage of it, and so that cost is not a shared cost.

Q. DOES DR. EMMERSON DISCUSS WHAT KINDS OF SHARED AND COMMON COSTS SHOULD BE RECOVERED IN THE PRICES OF UNBUNDLED NETWORK ELEMENTS AND INTERCONNECTION?

A. No, not directly. In his discussion of interconnection, however, he implies that prices

1 should be set in such a way as to ensure that BellSouth recovers some version of a
2 revenue requirement. (See, Emmerson Direct, page 25, lines 4-17)

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Q. DO YOU AGREE WITH HAVING PRICES FOR UNBUNDLED NETWORK ELEMENTS AND INTERCONNECTION BE SET IN A WAY THAT WOULD ENSURE THAT BELLSOUTH RECOVERS A REVENUE REQUIREMENT?

A. No. Allowing BellSouth to recover any more than its forward-looking economic costs based on being a wholesale-only firm in the prices for unbundled network elements and interconnection would prevent the market from driving local exchange rates to economic costs. This would deprive consumers in Florida of the full benefits of competition.

Allowing BellSouth to recover based on a revenue requirement would also be inconsistent with the Act. Section 252(d)(1)(A)(i) states:

(1) INTERCONNECTION AND NETWORK ELEMENT CHARGES.—Determinations by a State commission of the just and reasonable rate for the interconnection of facilities and equipment for purposes of subsection (c)(2) of section 251, and the just and reasonable rate for network elements for purposes of subsection (c)(3) of such section—
(A) shall be—
(i) based on the cost (determined without reference to a rate-of-return or other rate-based proceeding) of providing the interconnection or network element (whichever is applicable),

1 Q. DR. EMMERSON ALSO CALLS FOR PRICES TO BE SET ABOVE TELRIC
2 BASED ON THE VALUE OF THE SERVICE TO THE CUSTOMER AND THE
3 MARKET CONDITIONS. DO YOU AGREE WITH THIS APPROACH TO
4 SETTING PRICES ABOVE TELRIC FOR UNBUNDLED NETWORK ELEMENTS
5 AND INTERCONNECTION?
6

7 A. No. Allowing BellSouth to charge for unbundled network elements and
8 interconnection would allow it to use its market power to deter entry, contrary to the
9 goals of the Telecommunications Act of 1996.

10 The value of a service to a customer depends in part on the substitutes that are
11 available in the marketplace. Where there are no substitutes, all other factors equal,
12 a service will have a higher value to a customer than if there are substitutes. In
13 economic terms, the fewer the substitutes, the more likely it is that the service will
14 face inelastic demand. Thus, Dr. Emmerson's proposal is just a proposal to allow
15 BellSouth to take a higher markup on unbundled network elements where it possesses
16 the greatest market power, and a lower one where it does not. This would deter entry
17 by putting an undue recovery of common costs on those elements entrants need the
18 most. This is bad for consumers.

19

20 Q. MR. MILNER SAYS THAT THE UNBUNDLED NETWORK ELEMENTS THAT
21 MCI HAS REQUESTED EITHER ARE NOT TECHNICALLY FEASIBLE TO
22 PROVIDE OR ARE ALREADY AVAILABLE UNDER EXISTING TARIFFS. HAS
23 HE CORRECTLY DEFINED "TECHNICALLY FEASIBLE?"
24

25 A. No. Mr. Milner, in his rebuttal testimony in Docket No. 960833-TP, which he

1 incorporates by reference in this Docket, adds a number of criteria to those put forth
2 by the Federal Communications Commission to define what is “technically feasible.”
3 The effect of his additions is to allow BellSouth to use a claim that a requested
4 unbundled network element is not technically feasible to both subvert the clear intent
5 of the Telecommunications Act of 1996 (the Act) and to create a large barrier to entry.

6 BellSouth is required to provide access to unbundled network elements at “any
7 technically feasible point” under Section 251(c)(3) of the Act. The FCC defined
8 technical feasibility, and did not adopt the approach that Mr. Milner takes. Mr.
9 Milner, in discussing each of the network elements that has been requested that he
10 claims BellSouth cannot technically provide, argues that it cannot do so today with no
11 change to its network. This may be true, but is irrelevant. The BellSouth network
12 was not built with the idea of providing unbundled network elements to competitors.

13 As the FCC noted:

14 [U]se of the term “feasible” implies that interconnecting or providing
15 access to a LEC network element may be feasible at a particular point
16 even if such interconnection or access requires a novel use of, or some
17 modification to, incumbent LEC equipment. This interpretation is
18 consistent with the fact that incumbent LEC networks were not
19 designed to accommodate third-party interconnection or use of network
20 elements at all or even most points within the network. If incumbent
21 LECs were not required, at least to some extent, to adapt their
22 facilities to interconnection or use by other carriers, the purposes of
23 sections 251(c)(2) and 251(c)(3) would often be frustrated. For
24 example, Congress intended to obligate the incumbent to accommodate
25 the new entrant’s network architecture by requiring the incumbent to

1 provide interconnection "for the facilities and equipment" of the new
2 entrant. Consistent with that intent, the incumbent must accept the
3 novel use of, and modification to, its network facilities to accommodate
4 the interconnector or to provide access to unbundled elements.
5 (Paragraph 202)

6 Mr. Milner's refusal to provide Loop Distribution Media and Loop
7 Concentrator/Multiplexer based on a claim of technical infeasibility relies mainly on
8 the fact that today BellSouth has no automated ordering and inventory systems for
9 these elements and because providing access to these unbundled network elements
10 might prevent BellSouth from converting to a different loop technology in the future.
11 The first the FCC explicitly rejected as part of technical infeasibility. The second is
12 a near-textbook illustration of the desire of BellSouth to try almost any argument to
13 avoid providing technically feasible unbundled network elements.

14 Although the FCC declined to order subloop element unbundling, leaving that
15 question for the states to decide, it did note:

16 The record presents evidence primarily of logistical, rather than
17 technical, impediments to subloop unbundling. Several LECs and
18 USTA, for example, assert that incumbent LECs would need to create
19 databases for identifying, provisioning, and billing for subloop
20 elements. Further, incumbent LECs argue that there is insufficient
21 space at certain possible subloop interconnection points. We note that
22 these concerns do not represent "technical" considerations under our
23 interpretation of the term "technically feasible." (Paragraph 390,
24 footnotes omitted)

25 Thus, the FCC explicitly ruled out claiming lack of ordering and tracking systems as

1 a component of technical feasibility. Yet that is the first "minimum" criterion Mr.
2 Milner would have taken into account in determining technical feasibility.

3 Mr. Milner's arguments against providing these unbundled network elements
4 because doing so might in the future hinder a change of technology by BellSouth is
5 clearly designed to avoid providing unbundled network elements in order to delay or
6 impede entry. As the FCC noted:

7 As discussed above at sections II.A, II.B and V.B, we believe that
8 incumbent LECs have little incentive to facilitate the ability of new
9 entrants, including small entities, to compete against them and, thus,
10 have little incentive to provision unbundled elements in a manner that
11 would provide efficient competitors with a meaningful opportunity to
12 compete. We are also cognizant of the fact that incumbent LECs have
13 the incentive and the ability to engage in many kinds of discrimination.
14 For example, incumbent LECs could potentially delay providing access
15 to unbundled network elements, or they could provide them to new
16 entrants at a degraded level of quality. (Paragraph 307)

17 Neither of Mr. Milner's additions to the notion of technical feasibility as spelled out
18 in the FCC's Order should be accepted by the Commission. To do so would be to
19 allow BellSouth to create a very large barrier to entry.

20
21 Q. MR. MILNER ALSO SAID THAT BELLSOUTH COULD NOT PROVIDE
22 UNBUNDLED LOOPS WHERE BELLSOUTH USES INTEGRATED DIGITAL
23 LOOP CARRIER SYSTEMS. DID THE FCC ORDER UNBUNDLING IN THESE
24 CIRCUMSTANCES?

25

1 A. Yes. As the FCC said:

2 We further conclude that incumbent LECs must provide competitors
3 with access to unbundled loops regardless of whether the incumbent
4 LEC uses integrated digital loop carrier technology, or similar remote
5 concentration devices, for the particular loop sought by the competitor.
6 IDLC technology allows a carrier to aggregate and multiplex loop
7 traffic at a remote concentration point and to deliver that multiplexed
8 traffic directly into the switch without first demultiplexing the
9 individual loops. If we did not require incumbent LECs to unbundle
10 IDLC-delivered loops, end users served by such technologies would
11 not have the same choice of competing providers as end users served
12 by other loop types. Further, such an exception would encourage
13 incumbent LECs to "hide" loops from competitors through the use of
14 IDLC technology. (Paragraph 383)

15

16 Mr. Milner says that providing such unbundled loops is not technically feasible.

17 He claims that to unbundle such loops would have costs.

18 The FCC has stated that the methods of unbundling such loops that Mr. Milner
19 claims are not technically feasible are, in fact, technically feasible. Moreover, the
20 FCC explicitly rejected an argument that because an unbundling request would impose
21 costs, it should be considered to be technically infeasible. The Commission should
22 reject Mr. Milner's claim and require BellSouth to provide unbundled loops even when
23 they are provisioned using integrated digital loop carrier systems.

24

25 Q. FOR TWO OF THE REQUESTED UNBUNDLED NETWORK ELEMENTS, MR.

1 MILNER ALSO CLAIMS THAT BELLSOUTH ALREADY PROVIDES THEM
2 UNDER A DIFFERENT TARIFF SO THERE IS NO NEED FOR THEM TO BE
3 PROVIDED AS UNBUNDLED NETWORK ELEMENTS. IS THIS CONSISTENT
4 WITH THE FCC'S ORDER?

5

6 A. No. Entrants are entitled to have unbundled network elements priced to recover the
7 TELRIC of that element plus a reasonable share of the common costs of a
8 wholesale-only firm, as discussed above. Entrants are also allowed to use those
9 elements in any manner they desire to provide local exchange or exchange access
10 services. If the existing tariffed rates are above the FCC's cost standard, or if there
11 are any restrictions on how the services from the other tariff can be used, these tariffed
12 services are not a substitute for the right to have a facility provided as an unbundled
13 network element.

14

15 Q. MR. MILNER ALSO CLAIMS THAT IT IS NOT FEASIBLE TO PROVIDE
16 CUSTOMIZED ROUTING AS PART OF UNBUNDLED LOCAL SWITCHING.
17 DOES THIS COMPORT WITH THE ACT AND THE FCC'S ORDER?

18

19 A. No. Mr. Milner claims that there is not sufficient Line Class Code capacity on all of
20 BellSouth's switches to accommodate all potential entrants, so BellSouth should not be
21 required to provide it to any entrant. The FCC has included customized routing as
22 part of the unbundled switching element, noting only that it may not be feasible on
23 1AESS switches. The problem with Mr. Milner's position is that this violates the
24 requirement for nondiscrimination and the statutory requirement for dialing parity. It
25 also creates a barrier to entry.

1 The customized routing issue involves the ability to route operator, directory
2 assistance, 411, and 611 calls to either BellSouth's operator and repair services or to
3 an entrant's. If an entrant already provides its own operator services, for example, it
4 will want to package those with use of the unbundled local switching element when
5 providing services to its local exchange customers. If it cannot have those calls routed
6 to its own operators, it is forced to choose between having its customers dial many
7 more digits to be able to get to those same functions, or to use the operator services
8 of BellSouth. Both of these options are bad, the first because the lack of dialing parity
9 is itself a barrier to entry, and the second because it is more costly for the entrant.

10 Mr. Milner's solution is to keep all the Line Class Codes for BellSouth's use,
11 which discriminates in favor of BellSouth. This is wrong. Mr. Milner's approach also
12 is another example of his refusal to consider that changes may have to be made to the
13 existing network in order to accommodate entrants. Bell Atlantic-Pennsylvania has
14 reached an agreement with AT&T to provide customized routing using AIN starting
15 in April and completely by the end of June, 1997. If another incumbent local
16 exchange provider can provide this capability, then it is technically feasible for
17 BellSouth to do so also, at least within the same time frame as agreed to by Bell
18 Atlantic-Pennsylvania.

19
20 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

21
22 **A. Yes.**