

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

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In the Matter of

Petitions by AT&T Communications of
the Southern States, Inc., MCI
Telecommunications Corporation, MCI
Metro Access Transmission Services,
Inc., and American Communications
Services, Inc., and American
Communications, Services of
Jacksonville, Inc., for arbitration
of certain terms and conditions of a
proposed agreement with BellSouth
Telecommunications, Inc., concerning
Interconnection and Resale under the
Telecommunications Act of 1996.

: DOCKET NO. 960833-TP
: DOCKET NO. 960846-TP
: DOCKET NO. 960916-TP



FIRST DAY - MORNING SESSION

VOLUME 1

Pages 1 through 161

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN SUSAN F. CLARK
COMMISSIONER J. TERRY DEASON
COMMISSIONER JULIA L. JOHNSON
COMMISSIONER DIANE K. KIESLING
COMMISSIONER JOE GARCIA

DATE: Wednesday, October 9, 1996

TIME: Commenced at 11:30 a.m.

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

REPORTED BY: H. RUTHE POTAMI, CSR, RPR
ROWENA NASH HACKNEY
Official Commission Reporters

DOCUMENT NO.
10825-96
8/10/96

1 **APPEARANCES:**

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3 **WILLIAM ELLENBERG, BellSouth Telecommunications, Inc.,**
4 **c/o Nancy H. Sims, 150 South Monroe Street, Suite 400,**
5 **Tallahassee, Florida 32399-0850, appearing on behalf**
6 **of BellSouth Telecommunications, Inc.**

7 **TRACY HATCH, ROBIN DUNSON, and MICHAEL W.**
8 **TYE, AT&T Communications of the Southern States, Inc.,**
9 **101 North Monroe Street, Suite 700, Tallahassee,**
10 **Florida 32301-1509, MARK LOGAN, Bryant, Miller &**
11 **Olive, 201 South Monroe, Tallahassee, Florida, and**
12 **SANDY HOE, TOM LEMMER and TAMI LYN AZORSKY, McKenna &**
13 **Cuneo, 1900 K. Street NW, Washington, D.C. 20006,**
14 **appearing on behalf of AT&T Communications of the**
15 **Southern States, Inc.**

16 **RICHARD D. MELSON, Hopping Green Sams and**
17 **Smith, Post Office Box 6526, 123 South Calhoun Street,**
18 **Tallahassee, Florida 32302, Tallahassee, Florida**
19 **32314, and MARTHA McMILLIN, 780 Johnson Ferry Road,**
20 **Suite 700, Atlanta, Georgia 30342, appearing on behalf**
21 **of MCI Telecommunications Corporation and MCI Metro**
22 **Access Transmission Services, Inc.**

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1 APPEARANCES CONTINUED:

2 FLOYD R. SELF and NORMAN H. HORTON, JR.,
3 Messer, Caparello, Madsen, Goldman & Metz, P.A., 215
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6 National Business Parkway, Suite 100, Annapolis
7 Junction, Maryland 20701, and BRAD MUTSCHELKNAUS,
8 Kelley, Drye & Warren, 1200 19th Street N.W., Suite
9 500, Washington, D.C, appearing on behalf of American
10 Communications Services, Inc.

11 DONNA CANZANO, MONICA M. BARONE and CHARLIE
12 PELLEGRINI, Florida Public Service Commission,
13 Division of Legal Services, 2540 Shumard Oak
14 Boulevard, Tallahassee, Florida 32399-0850, appearing
15 on behalf of the Commission Staff.

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P R O C E E D I N G S

(Hearing convened at 11:30 p.m.)

CHAIRMAN CLARK: Call the hearing to order.

Would you please read the notice?

MS. CANZANO: Pursuant to notice issued September 12th, 1996, a hearing has been set for Docket Nos. 960833, 960846 and 960916 for this place. It was originally set to begin at 9:30, but due to the emergency agenda items that we had to take at 9:30, it is now scheduled to begin now, at 11:30.

CHAIRMAN CLARK: We'll take appearances.

MS. WHITE: Nancy White, R. Douglas Lackey and William Ellenberg, for BellSouth Telecommunications, 675 West Peachtree Street, Room 4300, Atlanta, Georgia, 30375. Also appearing on behalf of BellSouth Telecommunications is Robert Beatty and Phillip Carver of 150 West Flagler Street, Suite 1910, Miami, Florida, 33129.

MR. SELF: Floyd Self and Norman H. Horton, Jr., Messer, Caparello, Madsen, Goldman & Metz, P.A., 215 South Monroe Street, Tallahassee Florida, appearing on behalf of American Communications Services, Inc. Also appearing at the hearing will be James Falvey, 131 National Business Parkway, Suite 100, Annapolis Junction, Maryland, who is with ACSI;

1 also will be Brad Mutschelknaus of the Kelley, Drye &
2 and Warren law firm, 1200 19th Street NW, Suite 500
3 Washington, D.C.

4 **MR. HATCH:** Tracy Hatch, Robin Dunson,
5 Michael W. Tye, 101 North Monroe Street, Tallahassee,
6 Florida, appearing on behalf of AT&T. Also appearing
7 on behalf of AT&T will be Mark Logan of the Bryant,
8 Miller & Olive law firm, 201 South Monroe,
9 Tallahassee, Florida. Also appearing later in this
10 proceeding on behalf of AT&T will be Sandy Hoe, Tom
11 Lemmer and Tami Azorsky of the law firm of McKenna &
12 Cuneo, 1900 K Street Northwest, Washington, D.C.

13 **CHAIRMAN CLARK:** Hang on a minute.
14 Mr. Self, you need to give me the last attorney that's
15 going to appear before us and spell his name.

16 **MR. SELF:** Sure. His name is Brad
17 Mutschelknaus, and that is M-U-T-S-C-H-E-L-K-N-A-U-S,
18 and I've given the court reporter his card so she will
19 have it.

20 **CHAIRMAN CLARK:** Thank you. Mr. Hatch, you
21 need to do the same thing for the attorneys you
22 indicated will be appearing but are not listed on the
23 prehearing order.

24 **MR. HATCH:** Mark Logan of the Bryant, Miller
25 & Olive law firm. Sandy Hoe, H-O-E, Tom Lemmer,

1 L-E-M-M-E-R, Tammy Azorsky, A-Z-O-R-S-K-Y.

2 CHAIRMAN CLARK: And is it Ms. Hoe?

3 MR. HATCH: It's Mr.

4 MR. MELSON: Richard Melson of the law firm,
5 Hopping Green Sams & Smith, P.A., P.O. Box 6526,
6 Tallahassee, appearing on behalf of MCI
7 Telecommunications Corporation. Also appearing is
8 Martha McMillin of MCI Telecommunications Corporation,
9 780 Johnson Ferry Road, Atlanta, Georgia.

10 MS. CANZANO: Donna Canzano, Charlie
11 Pellegrini and Monica Barone appearing on behalf of
12 the Commission, and that's 2540 Shumard Oak Boulevard,
13 Tallahassee, Florida.

14 CHAIRMAN CLARK: Okay. Ms. Canzano, what do
15 we need to take up prior to taking our first witness?

16 MS. CANZANO: There are several preliminary
17 matters. One of them is MCI's motion for
18 reconsideration of the exclusion of its issues, and
19 they really are only addressing one issue for
20 reconsideration.

21 There's also a separate matter, which would
22 be discussion of posthearing procedures, at what
23 point -- some of the parties requested we may want to
24 have the Commission vote on that prior to the
25 conclusion of the hearing. I don't know if that's

1 still the case or not. And also at some point before
2 we begin, Staff would like to take official
3 recognition of certain orders.

4 CHAIRMAN CLARK: Okay. Ms. White, do you
5 have anything else we need to take up preliminarily?

6 MS. WHITE: No, ma'am.

7 CHAIRMAN CLARK: Mr. Self?

8 MR. SELF: No, ma'am.

9 CHAIRMAN CLARK: Mr. Hatch?

10 MR. HATCH: We've got a couple of matters.
11 One, the first one, is a simple administrative,
12 clerical thing. With respect to the prehearing order
13 list of witnesses where it lists the associated
14 issues, there are some errors in there that we need to
15 correct. The errors are my fault in its submission.
16 I'll read the whole list just to make sure that
17 everything gets picked up.

18 CHAIRMAN CLARK: Is there anything else?

19 MR. HATCH: Yes, ma'am.

20 CHAIRMAN CLARK: Mr. Melson?

21 MR. MELSON: No, ma'am, other than our
22 motion.

23 MR. TYE: Madam Chairman, there were two
24 other things. One has to do with the summaries.
25 Commissioner Deason ruled at the prehearing conference

1 that summaries be limited to five minutes, that we
2 would have the opportunity to request leave of the
3 Chair to expand those summaries in certain cases.

4 AT&T has one witness, Mr. Tamplin, that we
5 would like to request 15 minutes for; the reason being
6 that Mr. Tamplin is a witness that discusses the
7 unbundled network elements that are at issue in this
8 case, and he has a demonstration that we think will
9 help the Commission understand what we're talking
10 about. The unbundled network elements that we're
11 talking about here today go far beyond what the
12 Commission has had the opportunity to consider in the
13 past.

14 CHAIRMAN CLARK: Okay. And the third thing?

15 MR. TYE: The third thing is, we have a set
16 of the illustrative charts. In trying to keep our
17 summaries within five minutes, we put together some
18 charts for our witnesses to use in conjunction with
19 their summaries. They may use some of them, they may
20 use all of them. We've put these charts in binders to
21 pass out to the Commission so that you can refer to
22 them during the summary if you're not able to see the
23 chart, and we would like to pass those out at this
24 time.

25 CHAIRMAN CLARK: Mr. Tye, let me ask you if

1 you have checked with the parties about the length of
2 the summary for Mr. Tamplin to see if there's any
3 objection, and also the charts?

4 **MR. TYE:** We have talked to BellSouth about
5 the use of a multimedia presentation of that summary.
6 I think we have that matter resolved. I have not
7 discussed with them the length of the summary.

8 **CHAIRMAN CLARK:** And what about the charts?

9 **MR. TYE:** The charts we have not discussed
10 with anyone. They're basically just charts that are
11 part of the witness' summary. We thought it would be
12 more convenient if we just passed out these books for
13 the Commissioners and the parties to have while they
14 go through them.

15 **CHAIRMAN CLARK:** Well, then what I propose
16 to do is take up the clerical clarifications you wish
17 to make, then we'll take up the length of the summary,
18 the illustrative charts, and then we'll go to MCI's
19 motion; okay? Mr. Hatch.

20 **MR. HATCH:** If you would, with reference to
21 the list of witnesses, if you look for Mr. Cresse, the
22 issue there is incorrect. It should have been listed
23 as our basic position statement, that is his generic
24 policies testimony. With respect to Mr. Gillan, Issue
25 1(b), Issue 4 and Issue 21.

1 **CHAIRMAN CLARK:** Wait a minute. I'm not at
2 the right place. What page should I be on in the
3 prehearing order?

4 **MR. HATCH:** Page 6.

5 **CHAIRMAN CLARK:** Right.

6 **MR. HATCH:** With respect to Mr. Shurter --
7 did you get Mr. Gillan? It's 1(b), 4 and 21 for
8 Mr. Gillan. For Mr. Shurter it's 6 and 7, 8(b), 9, 11
9 through 13, 14(a), 15 through 17 and 19.

10 **CHAIRMAN CLARK:** Okay.

11 **MR. HATCH:** With respect to Mr. Tamplin,
12 it's 1(a), 2, 8(a), 9 through 11, 18 and 20. For
13 Mr. Kaserman, it's 1(b) and 4: For Mr. Ellison, it's
14 1(b), 18, 19, and 21. Mr. Sather is Issue 3 and 5.
15 Mr. Lerma is Issue 4. Mr. Carroll is 1 through 3, 5,
16 8, 13, 14(b) and 22. I apologize for any confusion
17 that may have caused.

18 **MR. LACKEY:** Could I ask him to give us
19 Dr. Kaserman's issue again?

20 **MR. HATCH:** Dr. Kaserman is 1(b) and 4.

21 **MR. LACKEY:** Thank you.

22 **CHAIRMAN CLARK:** Along those lines,
23 BellSouth, will you look at Page 16 under your
24 position? You have "BellSouth offers the following
25 response to 10(a) and (b). I assume that was 1(a) and

1 (b).

2 MS. WHITE: Yes, ma'am. The 10(a) was from
3 when the -- before the issues were renumbered, so it
4 should read 1(a) and (b).

5 CHAIRMAN CLARK: AT&T, if you would look at
6 your position on Issue 6, Page 23, the last paragraph
7 about midway, is there a word missing? It says "in
8 way would hold." I think it's "in no way," but I'm
9 not sure. It says "changes as an uncertainty of doing
10 business and, therefore, in way."

11 MR. HATCH: I believe you're right. I
12 believe that the word "no" is omitted there.

13 MR. PELLEGRINI: Madam Chairman, where are
14 you?

15 CHAIRMAN CLARK: I'm on Page 23, the
16 position of AT&T. The last full paragraph of their
17 position was missing "no," I think. Okay. Anything
18 else? (No response.)

19 The next item is the length of the summary
20 for Mr. Tamplin, and I assume he's going to use the
21 CD ROM.

22 MR. TYE: That's correct, Chairman Clark.
23 We will keep it within 15 minutes.

24 CHAIRMAN CLARK: Is there any objection from
25 any of the parties?

1 **MR. LACKEY:** Madam Chairman, I have seen the
2 presentation in North Carolina. Quite frankly, I
3 think it might be helpful for the Commission to see
4 it, because it does -- it's kind of cute, and it does
5 lay out the network. The only request we would have
6 is that they give us color slides of the pictures. In
7 North Carolina they had color slides of the screens
8 that Mr. Tamplin showed that went into the record, and
9 we would like to have that.

10 **CHAIRMAN CLARK:** Is that what you delivered
11 this morning?

12 **MR. TYE:** That's correct, I believe; and,
13 Doug, I believe you all have those.

14 **MR. LACKEY:** I just -- I'm getting here
15 late, so I'm not up to speed on some of those things.

16 **CHAIRMAN CLARK:** All right. So without
17 objection, we will allow Mr. Tamplin to make -- his
18 summary may extend for 15 minutes, and will include
19 the CD ROM -- presentation on CD ROM. The
20 illustrative charts, any objection to using the
21 illustrative charts?

22 **MR. LACKEY:** We, as I understand it -- and
23 I've seen, I think, most of the these charts before,
24 too. We have no objection to their supplementing
25 their summaries with charts as long as they have no

1 objection to us doing the same thing.

2 MR. TYE: We can live with that.

3 CHAIRMAN CLARK: Okay. Then we will allow
4 the illustrative charts.

5 Now, as I understand it, the last thing we
6 need to take up is MCI's motion for reconsideration on
7 Issue 21. Is that what it's limited to now,
8 Mr. Melson?

9 MR. MELSON: That's correct.

10 CHAIRMAN CLARK: Okay. You have asked for
11 oral argument on this.

12 MR. MELSON: Yes, I have.

13 CHAIRMAN CLARK: Has BellSouth objected to
14 the oral argument?

15 MS. WHITE: No, we have not. We don't think
16 it's necessary, but we're prepared to move forward if
17 the Commission would like it.

18 CHAIRMAN CLARK: Staff, did I have a
19 recommendation on the oral argument? The
20 recommendation is yes?

21 MR. PELLEGRINI: Yes, it is, Chairman Clark,
22 but I would suggest that we take up MCI's request to
23 consider the motion for reconsideration de novo first
24 since that would govern the oral argument if it were
25 granted.

1 **MR. MELSON:** Commissioner Clark, my argument
2 will be very short. I would like to address in the
3 argument why I believe that your reconsideration
4 should be de novo.

5 **CHAIRMAN CLARK:** I guess I envisioned it
6 that if we grant oral argument, that will be part of
7 your argument, that it should be based on a de novo
8 review and not what we have used in the past as far as
9 motions for reconsideration.

10 So is there a motion to grant the request
11 for oral argument? It would be limited to five
12 minutes.

13 **MR. MELSON:** Yes, ma'am.

14 **CHAIRMAN CLARK:** Without objection. Go
15 ahead, Mr. Melson.

16 **MR. MELSON:** Commissioners, this is a single
17 issue. The question is whether MCI should be
18 permitted in this case to arbitrate what is now Issue
19 21, was formerly Issue 9; what should be the
20 compensation mechanism for the exchange of local
21 traffic between MCI and BellSouth.

22 The prehearing officer, based on letter
23 briefs submitted by MCI and BellSouth, excluded this
24 issue at the prehearing conference, and the basis for
25 his ruling is set out at Pages 60 and 61 of the

1 prehearing order.

2 Essentially the prehearing officer found
3 that there is an agreement between MCI and BellSouth
4 that, among other things, addresses the compensation
5 mechanism for exchange of local traffic; that it was
6 therefore no longer an open issue between the parties
7 and therefore was not an issue which could be
8 arbitrated, and reasoned that to allow arbitration
9 would essentially render the agreement meaningless,
10 would discourage negotiated agreements, and would be
11 inconsistent with the spirit and intent of the Act.

12 If there were no provision in the agreement
13 dealing with this subject and MCI's ability to raise
14 it and to maintain positions on it, I believe the
15 prehearing officer's ruling would have been correct.

16 If you look, though, at Page 5 of our
17 motion, we quote from a provision in the contract
18 which says, in essence, that MCI shall not argue for
19 different treatment of local interconnection provided
20 that MCI shall not be precluded from maintaining any
21 positions in Florida and Tennessee.

22 Our understanding when we negotiated that
23 provision in the contract was that we could not
24 revisit the issue of compensation for local
25 interconnection in any of the states to which the

1 agreement applies, with the exception of Florida and
2 Tennessee.

3 BellSouth has argued that our ability to
4 litigate the issue of local interconnection was
5 intended to be limited to ongoing proceedings such as
6 your 984 and 985 dockets in which those matters were
7 at issue. Such a limitation was present in some
8 earlier drafts of the contract, but the contract as
9 signed did not contain that limitation, and MCI's
10 intention and belief is that the contract permits it
11 on the issue of local interconnection, to maintain any
12 position in Florida and Tennessee in any state
13 proceeding, including these state proceedings pursuant
14 to the Telecommunications Act of 1996.

15 With regard to the standard of review, I
16 frankly have no case authority that I can cite you
17 that you ought to reconsider the prehearing officer's
18 ruling de novo. In this situation, the prehearing
19 officer's ruling is tantamount to a motion to dismiss
20 from the arbitration proceeding one of the issues that
21 we raised in our petition.

22 To that extent, it's the type of ruling that
23 traditionally is made by the full Commission on a
24 motion to dismiss, and for that reason we believe that
25 it's appropriate in this circumstance that you review

1 the matter de novo.

2 And, again, the issue is ultimately
3 resolved, I believe, by a reading and an
4 interpretation of Section 2B of our agreement with
5 BellSouth which is set out in our motion. Thank you.

6 CHAIRMAN CLARK: Thank you, Mr. Melson.
7 Ms. White.

8 MS. WHITE: Yes. Madam Chairman, I'm going
9 to take the reverse first, the de novo standard. As
10 Mr. Melson himself has noted, he has cited nothing
11 that states that the standard for review of a motion
12 of reconsideration will be de novo. It has been for
13 the last few years the standard, has the prehearing
14 officer failed to consider some matter, or made any
15 mistake of fact or law. That was found by this
16 Commission, held by this Commission on an order issued
17 in 1993.

18 And when the rule that discusses
19 reconsideration of a prehearing officer's order was
20 amended, it was specifically done to clarify that the
21 review standard was reconsideration and not de novo,
22 and there were no exceptions to that. So I would
23 contend that the standard for review is one of
24 reconsideration, not de novo, and in that event,
25 Mr. Melson has raised nothing new, then, and nothing

1 different from what he argued to the prehearing
2 officer in the letter briefs and last week at the
3 prehearing conference.

4 We would contend that the agreement does
5 state that it is a partial agreement that definitely
6 includes the compensation mechanism for
7 interconnection, which is Issue 21. The Act
8 specifically states that a carrier may petition for
9 arbitration of open issues. That is not an open issue
10 between BellSouth and MCI. That is covered by this
11 agreement.

12 At the time the agreement was entered into,
13 there were ongoing hearings in North Carolina --
14 excuse me -- in Tennessee and Florida, state
15 proceedings, proceedings under the state statutes; and
16 it was the intent of this language to govern those
17 particular proceedings.

18 MCI has noted that for itself in North
19 Carolina where it says that it is not attempting to
20 rearbitrate these issues. They have also noted it in
21 their negotiation documentation with BellSouth where
22 when it comes to an issue that is covered by the
23 partial agreement, they specifically state "this is
24 agreed to as shown in the existing partial agreement."

25 So, therefore, we believe these issues are

1 covered by the partial agreement and should not be
2 arbitrated and, again, we believe the standard is one
3 of reconsideration and that MCI has not met that
4 burden. Thank you.

5 MR. MELSON: Let me respond very briefly in
6 two respects. First, the position that MCI has taken
7 in North Carolina is not applicable here. The
8 exception provision that says MCI may maintain any
9 position relates only to the states of Tennessee and
10 Florida. We acknowledge that. Because this language
11 does not apply to North Carolina, we cannot raise that
12 issue again in the North Carolina proceeding.

13 With respect to the standard of review,
14 Commissioners, even if you apply the traditional
15 standard of review, we believe the prehearing officer
16 has made an error of law in his interpretation of this
17 agreement, and that reconsideration on that grounds
18 would be appropriate. Thank you.

19 COMMISSIONER JOHNSON: Could I ask
20 Mr. Melson a question?

21 CHAIRMAN CLARK: Yes.

22 COMMISSIONER JOHNSON: Your last statement,
23 you believe that the prehearing officer made an error
24 of law with respect to his interpretation of the
25 statute.

1 **MR. MELSON:** Of the agreement.

2 **COMMISSIONER JOHNSON:** Of the agreement.

3 Explain that to me. I guess I don't understand how
4 his interpretation of the agreement is a mistake of
5 law.

6 **MR. MELSON:** It may be a question of fact
7 and law. It's a question of how this language in the
8 agreement should be interpreted. We believe the
9 language is clear and that the intent of the parties,
10 as reflected in the agreement, does not leave room for
11 interpretation. Probably calling it a mistake of law
12 was an overstatement on my part.

13 **COMMISSIONER JOHNSON:** Thank you.

14 **CHAIRMAN CLARK:** Mr. Melson, let me ask you
15 this: It seems to me that if it is a reconsideration
16 based on the Diamond Cab criteria, that in fact it is
17 not a mistake of law, but it's that the prehearing
18 officer overlooked or failed to consider in rendering
19 the order. And it seems to me that this exact
20 argument was in fact considered and it was not
21 overlooked.

22 **MR. MELSON:** Commissioner Clark, the
23 argument was made on the briefs. We did not have oral
24 argument on this issue at the prehearing conference.
25 As I read the written ruling on Pages 60 and 61, which

1 really sets out the rationale, I did not see a
2 reference to this provision of the agreement nor an
3 analysis of this provision of the agreement.

4 **CHAIRMAN CLARK:** But did you make those
5 arguments?

6 **MR. MELSON:** Yes, we did, and I assume they
7 were considered; but the fact that their consideration
8 is not detailed in the written order, I believe,
9 allows you to look and see whether in fact that was a
10 matter that was overlooked.

11 **CHAIRMAN CLARK:** Did I hear you say that you
12 don't think it was overlooked, but we can determine
13 that it was?

14 **MR. MELSON:** The order does not reflect that
15 it was considered. I don't know what the prehearing
16 officer's mental process was. I was saying that I
17 made that argument, and I would ordinarily assume that
18 the prehearing officer would have considered it, but
19 his written ruling does not reflect whether he did or
20 not.

21 **CHAIRMAN CLARK:** Okay.

22 **COMMISSIONER JOHNSON:** Let me ask one other
23 question to the extent -- because as you made your
24 oral argument -- and I read those pages. That was the
25 first thing that struck me, that it was not here. But

1 assuming that it was addressed and it was just not
2 written in the order itself, would you still believe
3 that you would have proper grounds for us to
4 reconsider this.

5 MR. MELSON: Commissioner, I believe so. In
6 my initial letter brief, we asked for a specific
7 written ruling on the issue so that any ruling could
8 be preserved for appeal. To the extent the written
9 ruling does not reflect all of the prehearing
10 officer's thinking, that should be corrected or, in my
11 judgment, you should reconsider and should reach a
12 different result.

13 COMMISSIONER JOHNSON: I'm sorry.
14 Mr. Pellegrini.

15 MR. PELLEGRINI: I wanted to point out that
16 on Page 60 of the ruling, Section 2B does appear. It
17 was fully considered in the prehearing officer's
18 ruling.

19 CHAIRMAN CLARK: Isn't that the provision
20 you wished to rely on, Mr. Melson?

21 MR. MELSON: Yes, it is.

22 CHAIRMAN CLARK: Commissioners?

23 COMMISSIONER JOHNSON: Could Staff walk me
24 through how it was considered, because I'm just
25 reading the reference that you cited me to. So it's

1 just that your interpretation of that particular
2 provision is different than the one articulated by
3 MCI?

4 **MR. PELLEGRINI:** What we found persuasive,
5 Commissioner Johnson, was the fact that the parties
6 jointly submitted the partial or interim agreement to
7 this Commission for approval under the Act, and it was
8 so approved by this Commission; that is, under the
9 Act.

10 **COMMISSIONER JOHNSON:** Right. But he's
11 suggesting that this wasn't one of the things that
12 they agreed upon, that with respect to Florida and for
13 Tennessee -- and I don't have the particular provision
14 now that he referenced -- but that these kind of
15 matters could continue to be addressed; and he read us
16 a couple sentences that suggested that.

17 I mean, no one is denying that they did sign
18 an agreement and that they did submit it and that it
19 was approved. He's arguing about two sentences
20 that -- or a section that perhaps would allow them
21 more leeway and more opportunity to explore these
22 particular issues in Florida. And I was just
23 wondering what you analyzed and how you analyzed those
24 particular provisions.

25 **MR. PELLEGRINI:** But I think a logical

1 extension of MCI's argument is that no provision --
2 under Section 2B, no provision of the interim
3 agreement would be applicable in Florida. And that
4 would seem to be an inconsistency, and as the
5 prehearing officer found, would tend to undermine the
6 order of the Commission approving the agreement. And
7 that is spelled out on Page 61.

8 **COMMISSIONER JOHNSON:** Is that what you're
9 arguing, that no provision -- that under Section 2B
10 there's no provision that you cannot come to this
11 Commission and argue?

12 **MR. MELSON:** That's correct. And that is
13 because we negotiated in the agreement to preserve
14 that right to bring the issues, and the Commission
15 approved an agreement that contained that provision
16 reserving those rights.

17 We believe that all of the issues that were
18 excluded by the prehearing officer on the basis of
19 being included in the agreement are proper issues in
20 this proceeding. We are seeking reconsideration only
21 on one of them because, (a), it is the most important
22 and, (b), it helps us focus the argument.

23 **MR. PELLEGRINI:** Chairman Clark, if I may.

24 **CHAIRMAN CLARK:** Yes, Mr. Pellegrini.

25 **MR. PELLEGRINI:** I would like to call your

1 attention to a portion of the prehearing officer's
2 ruling on Page 61, the second full paragraph, and I
3 would like to quote briefly. The prehearing officer
4 said this: "To accede to MCI's position that by
5 Section 2B of the agreement it is free to re-litigate
6 in this proceeding any items covered by the agreement
7 would be to render the agreement meaningless,
8 undermine thoroughly our recent approval of the
9 agreement, and strongly discourage parties from
10 negotiating interconnection agreements, contrary to
11 the spirit and the intent of the Act and this
12 Commission's policy to encourage negotiated
13 settlements."

14 **CHAIRMAN CLARK:** Thank you, Mr. Pellegrini.
15 Are there any other questions, Commissioners? (No
16 response.) Do I have a motion? (No response.)
17 Commissioners, with respect to the notion that we
18 review it de novo, to me this is like any other issue
19 that we have that the prehearing officer has to deal
20 with.

21 I know personally that I have denied the
22 inclusion of issues, and if we buy into the argument
23 that this is, in effect, a dismissal of this issue
24 from this proceeding, well, that happens all the time;
25 and I don't see that this is unique, in any way

1 requiring us to change the standard of review.

2 **COMMISSIONER KIESLING:** I move that we deny
3 the request for reconsideration de novo.

4 **COMMISSIONER JOHNSON:** Second.

5 **CHAIRMAN CLARK:** Without objection, that's
6 approved. And on the motion for reconsideration, on
7 the standards provided in the cab -- our standard for
8 review of a prehearing officer's order, is there a
9 motion that we grant reconsideration or deny
10 reconsideration?

11 **COMMISSIONER KIESLING:** I move that we deny
12 reconsideration. I think that the discussion that
13 Mr. Pellegrini has referred to shows me that the
14 prehearing officer did consider these items and that
15 there's nothing new that would support a change in the
16 prehearing officer's order.

17 **CHAIRMAN CLARK:** Second?

18 **COMMISSIONER JOHNSON:** Second.

19 **CHAIRMAN CLARK:** Without objection, then,
20 show the motion for reconsideration denied. Thank
21 you.

22 With respect to the posthearing procedures,
23 it would be my view that we hold that off until the
24 end. I know MCI has indicated that they don't have a
25 problem with what's been proposed so long as the

1 Commission is not limited to choosing in its entirety
2 one agreement or the other. I think that's worth
3 discussing as a way of proceeding posthearing, but
4 we'll take that up at the end of the hearing.

5 Let me also give you some information on
6 conducting the hearing. I intend to take very short
7 breaks for dinner and for lunch. We're going to
8 endeavor to get this done by early Friday. I don't
9 know if we can. We may have to go later, but we're
10 going to make a real effort to get it done. By early
11 Friday, I mean 5:00 Friday. Okay. And so that would
12 include going late tonight and going late tomorrow
13 night certainly, and we'll probably start early
14 tomorrow morning. Okay. Anything else I need to take
15 up before we move to the witnesses?

16 MS. CANZANO: Just that Staff would like --
17 Staff seeks official recognition. We have distributed
18 this to the parties, and if anybody else would like a
19 copy of this list of orders just see Staff.

20 CHAIRMAN CLARK: All right. We will go
21 ahead and mark as Exhibit 1 and admit in the record
22 the document entitled Orders for Official Recognition
23 for Docket 960833, 846 and 916. That will be Exhibit
24 1, so everybody has clear reference of what the Staff
25 has asked for official recognition of, and we will

1 officially recognize the orders listed in that
2 document.

3 (Exhibit 1 marked for identification.)

4 MS. CANZANO: Thank you.

5 CHAIRMAN CLARK: All right. Anything else?

6 (No response.)

7 CHAIRMAN CLARK: Mr. Cresse is our first
8 witness?

9 MS. DUNSON: Yes.

10 CHAIRMAN CLARK: I would like all the
11 witnesses that are here today to stand and be sworn in
12 at the same time.

13 (Witnesses collectively sworn.)

14 CHAIRMAN CLARK: Mr. Hatch or Mr. Tye?

15 MR. TYE: Madam Chairman, while Mr. Cresse
16 is taking the stand, we would like to pass out the
17 pamphlets and the charts that we discussed earlier,
18 and Mrs. Dunson will handle the -- excuse me --
19 Ms. Dunson will handle the direct examination of
20 Mr. Cresse.

21 MS. DUNSON: Good morning, Commissioners.
22 My name is Robin Dunson. I'm representing AT&T
23 Communications of the Southern States, Inc. I'd like
24 to call Mr. Cresse to the stand.

25

JOSEPH P. CRESSE

1
2 was called as a witness on behalf of AT&T
3 Communications of the Southern of the Southern States,
4 Inc. and, having been duly sworn, testified as
5 follows:

DIRECT EXAMINATION

6
7 **BY MS. DUNSON:**

8 Q Mr. Cresse, would you please state your name
9 and business address for the record?

10 A Joseph B. Cresse, P.O. Box 1876,
11 Tallahassee, Florida 32302.

12 Q By whom are you employed and in what
13 capacity?

14 A Messer, Caparello, Madsen, Goldman & Metz
15 law firm here in Tallahassee as a special consultant.

16 Q Did you cause to be prepared five pages of
17 direct testimony which was prefiled on behalf of AT&T
18 in this proceeding on July 31st, 1996?

19 A Yes, I did.

20 Q Do you have any changes or corrections to
21 this testimony?

22 A No, I do not.

23 Q If I asked you the same questions today as
24 are contained in your prefiled testimony, would your
25 answers be the same?

1 A Yes.

2 MS. DUNSON: Madam Chairman, I request that
3 Mr. Cresse's testimony be inserted into the record as
4 though read.

5 CHAIRMAN CLARK: The prefiled direct
6 testimony of Mr. Cresse will be inserted in the record
7 as though read.

8 Q (By Ms. Dunson) Mr. Cresse, did you also
9 prepare one exhibit which was attached to your direct
10 testimony?

11 A Yes.

12 Q Do you have any changes or corrections to
13 make to this exhibit?

14 A No.

15 MS. DUNSON: Madam Chairman, I would also
16 request that Mr. Cresse's Exhibit JPC-1 be marked for
17 identification.

18 CHAIRMAN CLARK: JPC-1 will be marked as
19 Exhibit 2.

20 (Exhibit 2 marked for identification.)

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DIRECT TESTIMONY OF

JOSEPH P. CRESSE

ON BEHALF OF AT&T COMMUNICATIONS

OF THE SOUTHERN STATES, INC.

Docket No. 960833-TP

**Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS, AND
OCCUPATION.**

A. My name is Joseph P. Cresse. My business address is Post Office Box 1876,
Tallahassee, Florida 32302. I am presently employed as a non-lawyer special
consultant at Messer, Caparello, Madsen, Goldman & Metz, P.A. law firm.

Q. PLEASE STATE YOUR BACKGROUND AND QUALIFICATIONS.

A. Please see Exhibit JPC-1 attached to my testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. To suggest a basic policy approach this Commission should adopt in reviewing and
determining the issues in this arbitration.

Q. WHY IS THAT SIGNIFICANT?

A. It is extremely significant because state commissions throughout this country must
take the initiative to promote competition to achieve the objectives of the
Telecommunications Act of 1996 (the "Act") to provide consumers with choices,
for all of their telecommunications needs. The Act envisions a competitive local
services market; however, as we know from past experience, introducing
competition in a monopoly market will not be easy. Without aggressive action by
state commissions to encourage and stimulate competition, this experiment will not
work.

Q. WHAT LEADS YOU TO THAT CONCLUSION?

1 A. A review of the history of introducing competition in telecommunications suggests
2 that existing monopolists, left to their own devices, will make the introduction of
3 competition as beneficial to themselves as they possibly can. This means that the
4 incumbent local exchange carriers ("LEC's") will interpret the competition
5 requirements of the Act as narrowly as they can in their efforts to minimize losses of
6 local service customers. Given the inherent difficulties of breaking up a 100 year
7 old monopoly, state commissions must be diligent in their efforts to promote local
8 competition.

9 **Q. WHAT IS THE BASIS FOR YOUR OPINION?**

10 A. I joined the Florida Public Service Commission in 1979. Just prior to that date,
11 consumers were permitted for the first time to provide their own phone instrument.
12 Before this occurred, a customer was required to rent a phone from the local phone
13 company in order to obtain phone service. After many years of litigation, and over
14 the protestations of the local phone companies, who claimed the attachment of
15 "foreign" phones to their network would harm their networks, competition was
16 introduced for customer premises equipment. For a while a useless "protector" was
17 required if a "foreign" phone was used by a LEC customer. (Many of the same
18 arguments were made when inside wire was deregulated.) Of course, as we know
19 now, such "protectors" proved unnecessary and simply served as another costly
20 impediment to competition.

21 Prior to the introduction of competition in the long distance industry, service was
22 provided jointly by the LEC's and AT&T Long Lines. The LEC's provided the
23 connections to and from individual customers for originating and terminating long
24 distance calls ("the last mile") and AT&T Long Lines provided the intercity
25 transmission facilities for such calls. Because new long distance competitors also

1 needed access to customer lines for originating and terminating long distance calls,
2 the major issue in establishing competition was the level of access charges other
3 long distance carriers would be required to pay LEC's for such access.

4 At the time, this access or interconnection between AT&T Long Lines and the
5 LEC's was of a higher quality and more convenient (requiring the dialing of fewer
6 digits) for customers than the interconnection provided to other long distance
7 competitors. The regulatory response to this disparity was to give a substantial
8 discount for less than "equal access." The discount was 55% for interstate calls and
9 35% for intrastate calls in Florida. To accomplish equal access, it was necessary for
10 regulators to order it. This regulatory policy provided incentives to the LEC's to
11 provide equal access to all long distance carriers as quickly as economically feasible
12 because the discount was eliminated when equal access was provided. I believe the
13 Commission should order similar incentives to encourage compliance with the
14 requirements set forth in the Act to bring about local exchange competition.
15 Also, until competition was established, regulators continued to require the
16 dominant carrier to satisfy more stringent regulatory requirements than those
17 imposed on new entrants for the filing of tariffs, the approval of rate changes, and
18 the "pass through" of reductions in access charges. Regulators also required that the
19 dominant carrier could not prohibit resale of its services. As a result, today we have
20 both resale competition and facilities based competition in the toll business.
21 Commission policy should embrace these same kinds of requirements to promote
22 local exchange competition.

23 **Q. WHAT RESPONSE TO THE INTRODUCTION OF COMPETITION**
24 **WOULD REQUIRE CLOSE REGULATORY SCRUTINY?**

25 **A. Based on past actions, and some current proposals, I would expect the incumbent**

1 LEC's to propose opening their local networks to competition in a manner that
2 retains for themselves all the advantages that regulators permit.

3 **Q. CAN YOU GIVE SOME EXAMPLES OF EXPECTED INCUMBENT LEC**
4 **RESPONSES TO ISSUES IN THIS DOCKET?**

5 **A.** Yes.

6 1. I would expect incumbent LECs to attempt to minimize the discounts on
7 resale to the maximum extent possible.

8 2. I would expect incumbent LEC's to minimize the network functions or
9 elements they believe should be unbundled.

10 3. I would expect incumbent LEC's to attempt to enter into long term contracts
11 with existing customers under their Contract Service Arrangements ("CSA's")
12 authority prior to any actual competition.

13 4. I would expect incumbent LEC's to offer differential pricing in those areas
14 where they have or soon expect competition, such as zone density-based access
15 charges.

16 5. I would expect incumbent LEC's to attempt to maximize their revenues from
17 interconnection and other services provided to new entrants.

18 6. I would expect incumbent LEC's to use universal service as a means to
19 extract the highest contributions possible from their competitors.

20 The Commission needs to recognize each of these tactics for what they are -
21 *attempts to limit competition* -- and take steps to ensure that consumers' interests
22 and not incumbent LECs' interests are protected.

23 **Q. ARE THERE OTHER FACTORS THE COMMISSION SHOULD**
24 **RECOGNIZE?**

25 **A.** Yes, at one time, under rate base regulation, *protecting the LEC's could be justified*

1 as protecting consumers, because any revenues lost would need to be "made up"
2 from remaining customers. This is no longer true under the form of regulation
3 applied to incumbent LEC's like BellSouth. The Commission has no authority to
4 prevent or approve rate changes. The maximum rates are established by Florida law
5 and regulated LEC's have the authority to set rates up to the maximum permitted.

6 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

7 **A. The absolute best way for this Commission to protect consumers is to promote**
8 **competition in Florida to the maximum extent permitted by law through the**
9 **adoption of orders and policies that increase choices for consumers.**

1 Q (By Ms. Dunson) Mr. Cresse, did you
2 prepare a summary of your testimony?

3 A Yes.

4 Q Would you please give it for the record?

5 A Yes. Commissioners, I'm recommending you
6 promote competition as much as legally possible in
7 every decision you make in this arbitration, and the
8 reason is fairly simple. It's the best possible way
9 for this Commission to provide protection to the
10 consumers of the state of Florida.

11 Promotion of competition is the only
12 available technique the Commission has, since the
13 statutes in Florida override the Commission's rate
14 setting ability, and all the rates that the local
15 exchange company can charge are authorized by statute
16 and no longer require approval of this Commission.

17 I mention in my testimony that I believe the
18 LECs will interpret the 1996 federal act as narrowly
19 as possible, as narrowly as they can for their own
20 benefit. I remind the Commission of some of the
21 things that have happened historically as we have
22 moved from a full monopoly to a competitive
23 telecommunications market.

24 Some of the Commissioners will remember when
25 you had to pay \$18.00 a year rent for a telephone that

1 only cost the local exchange company \$15.00, and you
2 had no choice but to take that phone from the local
3 exchange company. I remember there were arguments and
4 battles to permit consumers to acquire phones from
5 other than the local exchange company, and the LECs
6 resisted that change. As a matter of fact they
7 referred to a competitor phone as a foreign phone, and
8 claimed that if you hooked a competitive phone to the
9 network, it would blow out the network. We all know
10 that did not happen, and now each consumer has
11 competitive choice for customer premise equipment.

12 I also mention to you in my testimony what
13 the Florida Commission and the FCC did in the
14 introduction of competition in the long distance
15 business. There was not equal access for all
16 carriers, and the FCC provided a 55% discount in
17 access charges, and the State of Florida provided a
18 35% discount for access charges for less than equal
19 access.

20 We provide an incentive to the local
21 exchange companies to provide equal access because we
22 allowed them to charge the full rate and eliminate the
23 discount when equal access was available to all long
24 distance carriers; and as you know, equal access was
25 achieved very quickly in the state of Florida.

1 Much of the same arguments were made when
2 you were going to permit inside wire to be installed
3 on a competitive basis. At one time the telephone
4 company had to come out during the construction of
5 your house and put in telephone wire. No longer is
6 that required, but the arguments at that time were
7 that it would cause great harm; and that's been the
8 policy in this country and in this state for over 10
9 years, and I believe it's worked very well.

10 I mentioned there's some behavior that you
11 can expect from the local exchange companies in all
12 the issues you're trying to introduce as you're trying
13 to introduce competition in the local exchange
14 service. They will attempt to minimize discounts on
15 resale as it's in their best interests to do. They
16 will be entering into long-term contracts to try to
17 tie up their customers so when competition is finally
18 available, they will not have any competition for the
19 customers that they have signed long-term contracts
20 with.

21 They want to establish differential pricing
22 for access, simply because where they have competition
23 for access, the prices will decline, so they will want
24 to charge nonuniform prices for access for the use of
25 their local network.

1 They will try to maximize their revenues
2 from interconnection, and we've seen that happen
3 already. That's what they've been asking for, and
4 what they're asking in this case is contrary to what
5 the Commission has already decided and ruled on to be
6 reasonable and fair. They will want to minimize the
7 elements to be unbundled, because it's in their best
8 interests to have as few elements unbundled as
9 possible.

10 Finally, I mention that they will attempt to
11 maximize the contribution from other carriers for them
12 to carry out their universal service and carrier of
13 last resort responsibilities.

14 The best thing you can do for consumers in
15 Florida is to promote competition in every decision
16 you make in this arbitration. I'll be happy to answer
17 any questions.

18 Q So Mr. Cresse, does that conclude your
19 summary?

20 A Yes.

21 MS. DUNSON: The witness is available for
22 cross examination.

23 CHAIRMAN CLARK: Now, let me be clear. Does
24 MCI ask questions?

25 MR. MELSON: As I understand the prehearing

1 officer's ruling, it's only to the extent we've got
2 different positions on issues and need to elucidate
3 those through cross.

4 CHAIRMAN CLARK: Do you have any questions?

5 MR. MELSON: No.

6 CHAIRMAN CLARK: Mr. Self?

7 MR. SELF: No questions.

8 CHAIRMAN CLARK: Mr. Carver?

9 MR. CARVER: BellSouth has no questions.

10 CHAIRMAN CLARK: Staff?

11 MS. CANZANO: Staff has no questions.

12 WITNESS CRESSE: It must have been very

13 good.

14 CHAIRMAN CLARK: Wait a minute, Mr. Cresse.

15 I have to ask --

16 WITNESS CRESSE: Maybe not as good as I

17 thought.

18 CHAIRMAN CLARK: I think you spoke too soon.

19 WITNESS CRESSE: Yes, ma'am.

20 CHAIRMAN CLARK: Questions? (No response.)

21 No questions. Just a minute. I assume there's no

22 redirect. (Laughter.)

23 MS. DUNSON: May the witness be excused?

24 CHAIRMAN CLARK: Yes.

25 COMMISSIONER KIESLING: I think we might

1 make that deadline if we keep going like this.

2 MS. DUNSON: Madame Chairman, I move for
3 admission of Exhibit 2 into the record.

4 CHAIRMAN CLARK: It will be admitted without
5 objection.

6 (Exhibit 2 received in evidence.)

7 CHAIRMAN CLARK: Let me just ask the
8 parties, if we have witnesses we are not going to
9 cross examine, we can stipulate them into the record.
10 You're going to get a half an hour lunch
11 break and you will have an opportunity to look at it
12 then.

13 MR. LACKEY: There's only one other witness
14 that I'm debating not crossing, and I'm not sure yet,
15 but she won't be here until tomorrow, so I don't have
16 to worry about it today.

17 CHAIRMAN CLARK: Fine. I just would urge
18 everybody that if you don't have questions for a
19 witness, that you need to contact the party sponsoring
20 it so we can explore whether or not the testimony can
21 be stipulated into the record. Thank you.

22 Ms. Dunson?

23 MS. DUNSON: AT&T would like to call the our
24 second witness, Mr. Joseph Gillan.

25 CHAIRMAN CLARK: Mr. Gillan, you did stand

1 and get sworn in.

2

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3

JOSEPH GILLAN

4

was called as a witness on behalf of AT&T

5

Communications of the Southern States, Inc. and,

6

having been duly sworn, testified as follows:

7

DIRECT EXAMINATION

8

BY MS. DUNSON:

9

Q Mr. Gillan, would you please state your name

10

and business address for the record?

11

A Joseph Gillan, P.O. Box 541038, Orlando,

12

Florida, 32854.

13

Q By whom are you employed and in what

14

capacity?

15

A I'm self-employed as a consultant economist.

16

Q Did you cause to be prepared 45 pages of

17

direct testimony which was prefiled on behalf of AT&T

18

in this proceeding on July 31st, 1996?

19

A Yes.

20

Q Do you have any changes or corrections to

21

your direct testimony?

22

A Yes. I have two corrections.

23

Q Would you please identify those at this

24

time?

25

A Page 8, Line 24 is a reference to \$23

1 billion, which should be 24.5 billion. And Page 29,
2 Line 12, there's a reference to \$5.00, which should be
3 \$15.00.

4 Q Are those all of your corrections?

5 A Yes.

6 MS. DUNSON: Madam Chairman, I request that
7 Mr. Gillan's direct testimony be inserted into the
8 record as though read.

9 CHAIRMAN CLARK: It will be inserted in the
10 record as though read.

11 Q (By Ms. Dunson) Mr. Gillan, did you also
12 prepare two exhibits which were attached to your
13 direct testimony?

14 A Yes.

15 Q Do you have any changes or corrections to
16 make to those exhibits?

17 A No.

18 MS. DUNSON: Madam Chairman, I request that
19 Mr. Gillan's exhibits, JPG-1 and JPG-2 be marked for
20 identification.

21 CHAIRMAN CLARK: They will be marked as
22 Exhibit 3.

23 (Exhibit 3 marked for identification.)

24 Q (By Ms. Dunson) Mr. Gillan, did you also
25 prepare 15 pages of supplemental testimony which was

1 prefiled on behalf of AT&T in this proceeding on
2 August 23rd, 1996.

3 A Yes.

4 Q Do you have any changes or corrections to
5 make to your supplemental testimony?

6 A No, I do not.

7 Q If I asked you the same questions today as
8 are contained in your prefiled supplemental testimony,
9 would your answers be the same?

10 A Yes, they would.

11 MS. DUNSON: Madam Chairman, I request that
12 Mr. Gillan's supplemental testimony be inserted into
13 the record as though read.

14 CHAIRMAN CLARK: It will be inserted in the
15 record as though read.

16 Q (By Ms. Dunson) Mr. Gillan, did you also
17 prepare 13 pages of rebuttal testimony which was
18 prefiled on behalf of AT&T in this proceeding on
19 August 30th, 1996?

20 A Yes.

21 Q Do you have any changes or corrections to
22 your rebuttal testimony?

23 A No, I do not.

24 Q If I asked you the same questions today as
25 are contained in your prefiled rebuttal testimony,

1 would your answers be the same?

2 A Yes.

3 MS. DUNSON: Madam Chairman, I would also
4 like for Mr. Gillan's rebuttal testimony to be
5 inserted in the record as though read.

6 CHAIRMAN CLARK: It will be inserted in the
7 record as though read.

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DIRECT TESTIMONY OF

JOSEPH GILLAN

ON BEHALF OF AT&T COMMUNICATIONS

OF THE SOUTHERN STATES, INC.

Docket No. 960833-TP

I. QUALIFICATIONS AND PURPOSE OF TESTIMONY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando, Florida 32854.

Q. WHAT IS YOUR OCCUPATION?

A. I am an economist with a consulting practice specializing in telecommunications. My clients span a range of interests and have included state public utility commissions, consumer advocate organizations, local exchange carriers, competitive access providers and long distance companies.

Q. PLEASE BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND RELATED EXPERIENCE.

A. I am a graduate of the University of Wyoming where I received B.A. (1978) and M.A. (1979) degrees in economics. My graduate program concentrated on the economics of public utilities and regulated industries. In 1980 I joined the Illinois Commerce Commission where I had responsibility for policy analysis relating to the emergence of competition in regulated markets, in particular the telecommunications industry. While on the staff of the Commission, I served on the staff subcommittee for the NARUC Communications Committee and was appointed to the Research Advisory Council overseeing NARUC's research arm, the National Regulatory Research Institute.

1 In 1985 I left the Commission to join U.S. Switch, a venture firm organized to
2 develop interexchange access networks in partnership with independent local
3 telephone companies. At the end of 1986, I resigned my position of Vice President-
4 Marketing to begin a consulting practice. I currently serve on the Advisory Council
5 for New Mexico State University's Center for Regulation. A complete listing of my
6 background, publications and prior testimony is included as Exhibit JPG-1.

7 **Q. WHO IS SPONSORING YOUR TESTIMONY IN THIS PROCEEDING?**

8 A. My testimony is being sponsored by AT&T Communications of the Southern States,
9 Inc. ("AT&T"). Although sponsored by AT&T, the perspective that I will
10 emphasize is that of competition in general, and most importantly, the intended
11 beneficiary of competition, consumers. Competition is, after all, a process of
12 consumer-empowerment.

13 **Q. IS YOUR TESTIMONY PROMOTING COMPETITION FOR THE**
14 **BENEFIT OF CONSUMERS OR FOR THE BENEFIT OF AT&T?**

15 A. Primarily it is for the benefit of consumers. Competition now resides at the heart of
16 the nation's telecommunications policy. This is not because it benefits competitors,
17 but because it is the best mechanism to provide consumers with the lowest prices
18 and greatest choices -- and because where competition flourishes, regulation and
19 government intervention are unnecessary.

20 The fact that the parties before this Commission are large companies should not be
21 confused with the nature of their debate. In one corner, you have BellSouth, a
22 monopoly whose incentive is to do as little as possible to open its markets. In the
23 other corner, you have AT&T, an entrant with the desire to offer local services
24 broadly throughout Florida. Certainly, each party is primarily motivated by its own
25 self-interest, but the public-interest embodied in the Telecommunications Act of

1 1996 ("the Act") is providing consumers with choice. In this regard, AT&T's desire
2 to successfully compete with BellSouth and the public interest align.

3 **Q. PLEASE SUMMARIZE THE PRINCIPAL CONCLUSIONS OF YOUR**
4 **TESTIMONY.**

5 A. This proceeding represents a watershed event in the evolution of Florida's
6 telecommunications markets. Unlike earlier proceedings addressing local
7 competition, this arbitration is the first proceeding to *comprehensively* consider *each*
8 of the tools contemplated by the Act. The full mosaic of entry tools are needed if
9 AT&T (or any other carrier) is to broadly approach the market, offering service to
10 non-specific customers, residential and business alike. Because AT&T needs and is
11 requesting a full range of entry options -- options to which it is entitled under the
12 Act -- the Commission will be establishing not only conditions necessary for
13 AT&T's entry, but more significantly, the conditions of entry for the entire industry.
14 The purpose of my testimony is to emphasize the significance that this
15 Commission's decision in this proceeding will have on the future of competition. In
16 short, this Commission will be deciding whether Florida consumers in fact will have
17 choices, both now and well into the next decade.

18 Specifically, my testimony concludes that:

19 * The fundamental intent of the Act is a transition to an industry structure
20 where lines between carriers, services and markets disappear to the
21 maximum extent possible. The threshold predicate to this change is the
22 emergence of local competition -- not on a limited scale, or for a few
23 fortunate customers -- but on a broad scale to all residential and business
24 subscribers.

25 * The key factor that will determine the price that consumers pay for local

1 telephone services will be the price that competing carriers pay BellSouth
2 for wholesale local exchange services which are then resold to customers, as
3 well as the price carriers pay to BellSouth for unbundled network elements
4 and local interconnection.

5 * Resale of wholesale services and unbundling of network elements will
6 accelerate the deployment of alternative local networks and yield a far more
7 competitive environment at the end of the entry process than can otherwise
8 exist.

9 * Consumers will consider local competition a failure unless operational
10 support systems accommodate consumer movement from one local
11 exchange carrier to another on a level comparable to the process used to
12 move customers among long distance carriers. Implementing automated
13 systems that support broad-scale local competition requires that both
14 entrants (which have the incentive) and incumbents (which do not) design,
15 test, and implement these systems.

16 Finally, two precautionary notes concerning how rapidly the market will change
17 after the Commission reaches its decision in this proceeding. The correct decision
18 here should provide the *foundation* for competition and consumer choice. But local
19 competition will not be instantaneous. Implementing this Commission's decision
20 will take time. It is for this reason that the Commission should order each of the
21 comprehensive elements requested by AT&T so that competition can begin as soon
22 as possible.

23 Second, this proceeding concerns only half of the Act's fundamental equation:
24 opening BellSouth's monopoly in the local exchange market to competition. The
25 second half of the equation, allowing BellSouth to provide long distance services in

1 its territory -- while useful to understand the full impact of the Act -- is a question
2 that is relevant only *after* local markets become competitive. This single-minded
3 focus on opening the local exchange market to competition is appropriate because
4 establishing the right local entry conditions, by itself, is a substantial undertaking
5 that requires the Commission's undivided attention. The proverbial cart and horse
6 each has its role, but at this stage of the process, the issue is designing the cart.

7 **Q. HOW DOES YOUR TESTIMONY RELATE TO THE TESTIMONY OF**
8 **OTHER AT&T WITNESSES?**

9 A. My testimony describes the interrelationship among the requests in AT&T's
10 arbitration petition and how these requests fit within an overall strategy to
11 implement the Act. Other witnesses will provide detailed explanations of AT&T's
12 requests for wholesale services, unbundling of network elements and local
13 interconnection; the appropriate economic pricing principles to apply; as well as the
14 particular dimensions of the operational support systems being requested. My role
15 is to explain how these carrier-to-carrier issues can be expected to yield tangible
16 benefits in the prices and choices experienced by consumers.

17 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

18 A. In testimony sections which follow, I:

- 19 * describe the competitive environment envisioned by the Act, with
20 particular emphasis on its effect on consumer prices and choices
21 (Section II);
- 22 * explain the particular importance of local services resale to
23 achieving broad customer choice and accelerated entry (Section III);
- 24 * present the fundamental role of unbundled network elements to
25 achieving the competitive structure contemplated by the Act

1 (Section IV);

2 * conclude with a discussion of the importance of operational changes
3 needed to provide consumers with the widest choices with the least
4 disruption (Section V).

5 **II. ACHIEVING THE COMPETITIVE ENVIRONMENT OF THE**
6 **TELECOMMUNICATIONS ACT**

7 ***A. The Competitive Environment***

8 **Q. PLEASE DESCRIBE THE LONG-TERM COMPETITIVE ENVIRONMENT**
9 **ENVISIONED BY THE ACT.**

10 A. The long-term competitive environment contemplated by the Act is an industry
11 structure unseen since the divestiture of the Bell System in 1984: the emergence of
12 the full service provider, or, in other words, a single firm offering local and long
13 distance services. Of course, this time around, the goal is *multiple* full service
14 providers, and not the reemergence of the Bell monopoly. Contemporary labels
15 such as interexchange carrier (“IXC”), competitive local exchange carrier (“CLEC”)
16 and local exchange carrier (“LEC”), that today distinguish carriers, will disappear in
17 the eyes of consumers.

18 The threshold condition necessary to achieving this competitive environment is a
19 system of arrangements between carriers for the resale of wholesale services, the
20 use of network elements and reciprocal compensation. These basic tools will foster
21 robust competition where consumer benefits will arise relatively quickly while the
22 much slower process of duplicating networks moves forward.

23 Importantly, Congress took the steps necessary to effect the transition to a fully
24 competitive environment by adopting a completely new framework to govern the
25 relationship between incumbent local exchange carriers (“LECs”) and other carriers.

1 This *carrier-to-carrier* framework provides entrants quite different entitlements --
2 and imposes on incumbent LECs quite different obligations -- than have existed in
3 the past. This carrier-to-carrier framework enables entrants to use the incumbent's
4 existing network to fashion their own local exchange and exchange access services
5 on an economic basis comparable to BellSouth.

6 **Q. WHAT ARE THE CORE ELEMENTS OF THE CARRIER-TO-CARRIER**
7 **FRAMEWORK OUTLINED BY THE ACT?**

8 A. The core provisions describing these new carrier-to-carrier relationships are
9 contained in Sections 251 and 252 of the Act. In simple terms, these Sections
10 impose on incumbent LECs, like BellSouth, the obligation to permit the resale of its
11 retail services at wholesale prices, to unbundle its network and sell these elements to
12 entrants at cost-based rates, and to implement a system of reciprocal compensation
13 for the termination of traffic. It is important to understand that these items when
14 added together form the backbone of the relief AT&T seeks and are not options
15 which BellSouth may, or may not, fulfill at its whimsy. Rather, these are clear
16 obligations which Congress adopted in order to effect a fundamental change in the
17 industry by promoting robust local competition.

18 **Q. WHY WOULD CONGRESS HAVE ADOPTED CARRIER-TO-CARRIER**
19 **ARRANGEMENTS WHICH PROVIDE ENTRANTS THESE RIGHTS?**

20 A. The Act fundamentally recognized that full retail competition would be seriously
21 delayed, if not effectively foreclosed, if it first required the building of new
22 competitive exchange networks -- networks which, in some areas, may never be
23 constructed. The Act removed this impediment by making the existing LEC
24 networks available to rivals, so as to provide consumers choices more quickly and to
25 stimulate competition in order to accelerate the building of new competitive local

1 exchange networks.

2 **Q. WHY DON'T CARRIERS SIMPLY CONSTRUCT THEIR OWN LOCAL**
3 **NETWORKS?**

4 A. While some limited local networks are under construction, no carrier can construct
5 ubiquitous local networks capable of supporting broad competition. No one knows
6 this better than BellSouth. The BellSouth exchange network in Florida is massive,
7 connecting nearly 3.3 million residential housing units (Source: BellSouth USF
8 Submission, 1993 data) and essentially every commercial enterprise in its territory.
9 Although BellSouth has sometimes sought to paint these statistics as a disadvantage
10 -- implying that its network is the result of a "governmental obligation" as opposed
11 to its own financial self-interests -- the ubiquity, reach and capacity of this network
12 is enormous.

13 **Q. IS LOOP CAPACITY THE MOST SIGNIFICANT MEASURE OF THE**
14 **DOMINANCE OF BELLSOUTH'S EXCHANGE NETWORK?**

15 A. No. Measuring the network solely in terms of loops (i.e., the last connection to the
16 customer) significantly understates the enormous (in fact, unprecedented)
17 investment that would be necessary for even a single provider -- much less, the
18 multiple providers necessary for a fully competitive environment -- to duplicate
19 BellSouth's network. In addition to the loop plant to each and every premise in its
20 territory, BellSouth's exchange network (as of 1993) encompassed nearly 214 local
21 switches (including remotes) interconnected by a vast web of interoffice facilities.
22 Overall, the BellSouth network represents more than \$10 billion in investment in
23 Florida alone (Source: 1995 ARMIS 43-01, Total Plant in Service). In contrast,
24 AT&T's *worldwide* investment is approximately ^{24.5}\$23 billion. (Source: AT&T 1994
25 Form M.) Because of the size and geographic reach of BellSouth's network, local

1 competition would develop at a snail's pace unless this network can be used by other
2 carriers to provide local exchange and exchange access services.

3 **Q. IS THE ACT INTENDED PRIMARILY TO PROVIDE CARRIERS WITH**
4 **NEW BUSINESS OPPORTUNITIES?**

5 A. No. In my opinion, the Act's ultimate purpose is to provide consumers with local
6 choices as they now enjoy in long distance, to eliminate confusion caused by the
7 divestiture of the Bell System (separate providers of intraLATA and interLATA
8 services) while retaining all of the divestiture's competitive benefits, and to set the
9 stage for less regulation of consumer prices. However, the path to lower consumer
10 prices, newer services and increased convenience is through the tools contemplated
11 by these new carrier-to-carrier arrangements. The purpose of the Act will not be
12 fulfilled unless comprehensive carrier-to-carrier arrangements are implemented.

13 ***B. The Competitive Environment And Consumer Prices***

14 **Q. HOW CAN FULL IMPLEMENTATION OF THE ACT BE EXPECTED TO**
15 **BENEFIT CONSUMERS?**

16 A. The Act is fundamentally about choice. Choice for consumers is made possible
17 through the carrier-to-carrier arrangements that will underlie the service offerings of
18 new competitors. This is why correctly arbitrating carrier-to-carrier arrangements is
19 so important -- these agreements ultimately translate to the choices and price levels
20 that consumers experience. Much as the visible contours of the earth's surface (its
21 mountains, valleys and plains) are determined by underlying geographic conditions,
22 so too will consumer choices and prices be decided by the underlying conditions of
23 these carrier-to-carrier arrangements.

24 **Q. HOW WILL PRICES FOR UNBUNDLED NETWORK ELEMENTS AND**
25 **INTERCONNECTION INFLUENCE RETAIL RATES?**

1 A. BellSouth's competitors will use unbundled network elements and interconnection
2 to provide local exchange services to consumers and exchange access services to
3 other carriers. With correctly priced network elements and interconnection (which
4 is to say, prices based on economic cost), these entrants will be able to offer -- and
5 competition will force them to offer -- local exchange services at prices no higher
6 than today's prevailing (i.e., BellSouth's) rates.

7 Importantly, once competition is established through unbundled network elements
8 and interconnection, the existence of multiple providers of local exchange services
9 will constrain BellSouth's own pricing behavior. BellSouth will not be able to raise
10 local exchange prices to consumers because these consumers will have a choice of
11 other providers. There is simply no consumer protection stronger than the ability to
12 "take your business elsewhere."

13 This logic, while simple, is so important that it bears repeating. As entrants first
14 approach the market, they are constrained by BellSouth's retail prices. The entrant
15 must provide service at prices no higher than the prices of the incumbent LEC in
16 order to attract and retain customers. Cost-based network elements and
17 interconnection rates should provide this ability because both the entrant and
18 BellSouth would incur the same cost for the underlying network used to provide
19 service. If BellSouth profitably can provide service at today's rates, then so too
20 should the entrant. Having entered the market, these entrants then become the
21 constraint on BellSouth's prices, limiting BellSouth's ability to raise rates in the
22 future.

23 However, the entire basis for the above conclusion is that unbundled network
24 elements and interconnection arrangements used by the entrant are priced at
25 economic cost. If so, then the entrant and BellSouth each will face the same

1 underlying cost of the facilities needed to provide service. So long as these carrier-
2 prices facilitate profitable initial entry, then competition should provide sustained
3 pressure on price levels in the future.

4 **Q. WHAT WOULD HAPPEN IF THESE PRICES ARE INFLATED ABOVE**
5 **THEIR COSTS?**

6 A. The result would be higher consumer prices and fewer choices. BellSouth would be
7 able to increase the costs of its rivals, limiting their ability to compete with lower
8 prices.

9 **Q. IS THIS WHY THE COMMISSION SHOULD MAKE SURE THAT**
10 **UNBUNDLED NETWORK ELEMENTS AND INTERCONNECTION**
11 **PRICES ARE ESTABLISHED CORRECTLY?**

12 A. Yes. The Act represents a fundamental shift in regulatory focus from *directly*
13 setting retail prices and service dimensions (such as the size of local calling areas) of
14 local exchange carriers, to *indirectly* influencing retail services through the review
15 of the underlying carrier-to-carrier arrangements. If unbundled network elements
16 and interconnection prices are correctly established, then both BellSouth and other
17 providers will be able to compete upon a common foundation, at least with respect
18 to the cost of the underlying network.

19 **Q. WHAT WILL HAPPEN TO THE RESIDENTIAL LOCAL EXCHANGE**
20 **SERVICE THAT BELL SOUTH CLAIMS IS PRICED BELOW COST?**

21 A. The answer to this question has both a short and long run component. For the sake
22 of discussion, *assume* that residential local exchange prices do depend upon the
23 excessive pricing of other services, principally access charges. (This is a claim that
24 I do not necessarily accept, but I will not dispute here).

25 In the short-run, entrants are likely to provide services either through resale or

1 through a heavy, perhaps complete, reliance on network elements obtained from
2 BellSouth. In the resale scenario, BellSouth *retains* all access revenues, even those
3 of the reseller's customers. This arrangement seriously undermines the usefulness of
4 resale to the entrant (discussed in more detail in Section III below), but at least it
5 eliminates any claimed pressure by BellSouth to increase its local rates.

6 In the scenario where the entrant provides local services using unbundled network
7 elements, the entrant fully compensates BellSouth for the economic cost of the
8 facilities and the entrant provides the access service. If BellSouth is correct that
9 local rates are below cost, then both BellSouth and the entrant (who has paid
10 BellSouth for the cost of its facilities) will have a revenue shortfall. But, in this
11 scenario, both BellSouth and the entrant have the respective access revenues from
12 their own customers to offset any revenue shortfall, again eliminating any alleged
13 need for local rates to increase.

14 However, in the long run, the competitive environment envisioned by the Act (if not
15 the plain language of the Act itself) requires that all carrier-to-carrier prices be
16 nondiscriminatory and cost based. This means that the excessive revenues currently
17 embedded in access charges must end. If long term support to local rates is
18 determined to be needed, then such support must be explicitly provided through a
19 universal service fund. Of course, any such funding must be equally available to
20 both the entrant and BellSouth so as to not disrupt the consumer's choice of
21 provider. The Act requires that any universal service mechanism be
22 nondiscriminatory.

23 *C. The Importance of Quickly Reducing Local Entry Barriers*

24 **Q. WHY IS IT IMPORTANT TO REDUCE LOCAL ENTRY BARRIERS**
25 **QUICKLY?**

1 A. As noted earlier, the fundamental balance of the Act is to establish the tools needed
2 for other carriers to offer local services and, once effective competition is firmly
3 established, to permit BellSouth to offer long distance services in its territory.

4 Unlike the very real obstacles to local competition faced by rivals, the barriers
5 confronting BellSouth essentially can be eliminated "at the stroke of a pen." Once
6 legal restrictions are removed, BellSouth will be able to offer long distance services
7 quickly and completely.

8 Barriers to entry in the long distance market are low because there is competition at
9 *both* the retail and wholesale levels. At the wholesale level, a variety of companies
10 compete to provide the central ingredients of long distance services -- transmission,
11 switching, and billing. In effect, the long distance equivalents to unbundled network
12 elements and resale of wholesale services already are in place. A new entrant to the
13 long distance market need not construct its own network or wait for the development
14 of back-office systems to offer its services. The long distance industry already has
15 developed the necessary infrastructure to support a multi-vendor, competitive
16 environment.

17 **Q. WILL BELLSOUTH BENEFIT FROM THIS MULTI-VENDOR**
18 **INFRASTRUCTURE WHEN IT IS PERMITTED TO PROVIDE**
19 **INTERLATA SERVICES IN ITS TERRITORY?**

20 A. Yes. BellSouth is in a position to capitalize on the fruits of the long distance
21 industry's history with competition. Once legal authority is granted, BellSouth could
22 begin offering long distance services without investing in a single switch or strand
23 of optical fiber, obtaining a single right of way, or negotiating a single
24 interconnection agreement with a recalcitrant monopolist. BellSouth simply would
25 need to choose an underlying interexchange network supplier -- indeed, it has

1 already chosen AT&T for just this purpose -- and begin marketing long distance
2 services to its preexisting base of local customers, which today, is the *entire* market
3 in its exchanges.

4 BellSouth's path to becoming a long distance carrier is well-established, tested and
5 routine. It is a feat accomplished by thousands of firms since divestiture. Assisting
6 BellSouth in its task of adding long distance service is a competitive long distance
7 market with four national networks (plus a number of regional networks). Local
8 exchange company operational systems (i.e., presubscription processes) already are
9 sized to process large numbers of consumer requests to change long distance
10 carriers. Moreover, consumers are accustomed to changing long distance providers.
11 Further, there is the issue of excess capacity in BellSouth's extensive interLATA
12 "official services" network that was investigated, but never resolved, in the last Bell
13 rate proceeding (Docket 920260-TL). Merrill Lynch estimates that 50% of the long
14 distance traffic completes in region and could be carried on these facilities if
15 regulators permit BellSouth to convert its "official services" network to commercial
16 purposes.

17 In contrast, the steps to local competition -- even competition which rests
18 substantially or entirely on the use of BellSouth's existing network -- remain more
19 theory than reality. This Commission must ensure that this theory turns into reality.

20 **Q. WHAT WOULD BE THE EFFECT OF BELLSOUTH'S ENTRY INTO THE**
21 **LONG DISTANCE MARKET WITHOUT FIRST ESTABLISHING WIDE-**
22 **SCALE LOCAL COMPETITION?**

23 **A.** If a large portion of the market prefers to obtain its telecommunications services as a
24 package -- and there is general consensus that this is the case -- then the absence of
25 competition for *any* element of the package (i.e., local exchange service) would

1 distort competition for *all* services that are, or, more precisely, will be, sold as a
2 package. Because local exchange service will likely be seen as a compulsory
3 element of the package in the eyes of many (if not most) consumers, local service
4 *must* become competitive or competition for other services, such as long distance,
5 will suffer.

6 The re-creation of the Bell System monopoly is not what Congress intended or
7 consumers deserve. The Bell System divestiture was successful. Barriers to long
8 distance entry were greatly reduced, AT&T lost its monopoly, fiber and digital
9 technology was rapidly deployed, prices fell, and consumers enjoyed choice in
10 virtually every market. The Act essentially extends the pro-competitive policies of
11 the Bell System divestiture to all services. Just as divestiture provided AT&T's
12 competitors with access to the local network on equal terms in order to originate
13 and terminate long distance calls, the Act makes the local exchange network
14 available to competitors on equal terms for every purpose, including to originate and
15 terminate local calls.

16 *D. The Tools of Comprehensive Entry: Resale and Network Elements*

17 **Q. HOW WILL COMPETITION PROCEED DESPITE THE DOMINANCE OF**
18 **BELLSOUTH'S NETWORK?**

19 A. Congress recognized the massive dominance of the incumbent LEC's network and
20 the reality that it will take many years for the local transmission (especially loop)
21 market to become as competitive as the interexchange transmission market.
22 Alternative networks will take time to develop. As a result, the Act provides for a
23 number of entry strategies that rely, to one extent or another, on the immediate use
24 of the incumbent's facilities and services by other providers, so that local
25 competition may develop quickly.

1 Each of these strategies can be found in the central components of AT&T's requests
2 that led to this arbitration. These key components include AT&T's request to:

- 3 * resell wholesale equivalents of BellSouth's retail services,
- 4 * provide local exchange and exchange access services using network
5 elements obtained from BellSouth as basic ingredients to AT&T's
6 services, and
- 7 * terminate traffic under reciprocal compensation arrangements.

8 In later sections of my testimony, I address more extensively the importance of
9 wholesale services (Section III) and network elements (Section IV) to providing
10 exchange services. The point that I would like to emphasize here is the significance
11 of *comprehensively* establishing the basic conditions of local competition as raised
12 by this arbitration.

13 **Q. WHY IS AT&T'S REQUEST SO COMPREHENSIVE?**

14 A. The most important characteristic of the instant arbitration is its breadth. It
15 addresses *each* of the entry options contemplated by the Act: namely, the resale of
16 wholesale services, unbundled network elements, and reciprocal compensation for
17 traffic termination. Previous entrants before the Commission were either niche
18 entrants with little or no market presence or, in the case of a cable television
19 company, a potential entrant that intended to leverage a preexisting network.
20 However, at this point, cable entry remains largely a theoretical event.
21 No carrier has approached the market with the desire to serve a broad cross-section
22 of consumers scattered widely across a large, multi-state geographic region. No
23 carrier, that is, until AT&T. AT&T already serves a geographically scattered
24 customer base. If consumers do prefer to buy local and long distance service as a
25 package, AT&T's continued success in the long distance business depends upon its

1 ability to provide local service. The same is true for other long distance carriers.

2 **Q. HOW DO THE ISSUES OF COMPREHENSIVE ENTRY DIFFER FROM**
3 **THOSE IN PRIOR REQUESTS?**

4 A. There are at least three features of AT&T's request that differ from previous
5 dockets: the (1) intended *scale* of entry, (2) *applicability* to other entrants, and (3)
6 the need for systems to support customer choice with a *convenience* already
7 accepted in the market.

8 First, by scale of entry I mean AT&T's ability to broadly address its existing base of
9 subscribers. No single entry vehicle is best suited for every customer and
10 geographic consideration. Some strategies -- loop resale for instance -- are
11 particularly ill-suited for mass application because they either require physical
12 circuit rearrangements as customers move between providers or presuppose the
13 extensive deployment of alternative networks which do not now exist. Broad entry
14 requires that the full range of entry strategies be available so that a carrier may tailor
15 its offerings to particular conditions.

16 Second, because AT&T's request is so comprehensive, its value extends beyond this
17 single entrant to an entire industry. By encompassing all possible entry strategies,
18 AT&T's request necessarily includes the individual approaches that other carriers
19 will use to address their markets. This observation is particularly important. By
20 deciding the AT&T arbitration, the Commission is establishing the conditions of
21 entry not just for AT&T, but effectively defining the entry conditions for any entrant
22 that will use all (or part) of BellSouth's network to provide local services.

23 Third, just as the development of meaningful long distance competition required
24 new systems to support a multi-vendor environment, meaningful local competition
25 will not succeed without a similar commitment of industry resources to operational

1 support. Consumers will widely perceive local competition -- and the Congressional
2 action upon which it relies -- as a failure if changing local telephone companies is
3 associated with extended delays, high costs, periods of outage, unreliable bills, or
4 disrupted services. Operational systems are absolutely critical to robust competition
5 in the local exchange market.

6 The process with which consumers are familiar -- and which BellSouth will use to
7 enter the long distance market -- allows consumers to change long distance carriers
8 (i.e., their primary interexchange carrier, or "PIC") with a simple telephone call or
9 stroke of the pen. It is an easy, streamlined process. The operating standards of this
10 process, in terms of cost, speed and accuracy, should become the standard for
11 judging systems used to change local service providers as well.

12 *E. Entry and Facilities Deployment*

13 **Q. IF CARRIERS CAN OFFER SERVICES USING BELLSOUTH'S**
14 **NETWORK, WILL THEY ALSO CONSTRUCT COMPETING**
15 **NETWORKS?**

16 **A.** Certainly, but local facilities deployment is a longer-term proposition. It took the
17 Bell operating companies more than 100 years to achieve the present state and the
18 Commission should not expect entrants to deploy comparable networks overnight.
19 No company employing sound business judgment would expend the type of capital
20 it will take to deploy extensive local networks without strong evidence that it can
21 succeed in this market. In this respect, wholesale services and unbundled network
22 elements permit carriers to begin operation and gain needed experience to more
23 efficiently design and plan investment strategies.

24 In addition, entry using BellSouth's network will permit entrants to build the
25 necessary revenue streams to justify the massive investment necessary to construct

1 even relatively modest local networks. It is useful to remember that the gross plant
2 of the RBOCs is more than \$ 200 billion, nearly *10 times* that of AT&T (Source:
3 FCC Statistics of Communications Common Carriers, 1993/94). This buildup of
4 local plant also took place over decades, not overnight.

5 As entrants build their base of customers using wholesale services and unbundled
6 network elements, only then will they be able to make rational investment decisions
7 concerning where to construct networks, invest in switching, add new capabilities,
8 etc. Teleport, in fact, has publicly stated that its business strategy is to win
9 customers first and then build facilities in an efficient way to serve them
10 (Telecommunications Reports, October 16, 1995, page 20). With tangible market
11 experience and a strong customer base, entrants are more easily able to raise capital,
12 and just as importantly, convince their shareholders of the wisdom of their actions,
13 thereby accelerating the deployment of alternative networks.

14 **Q. DOES THIS PROCESS PARALLEL THE DEVELOPMENT OF FACILITIES**
15 **COMPETITION IN THE LONG DISTANCE MARKET?**

16 A. Yes. In the long distance market, early entrants like MCI were able to expand their
17 services and customer base by reselling services off of AT&T's network. This
18 growth financially justified the deployment of their own networks providing internal
19 investment capital and shareholder confidence, and encouraged the entry of others,
20 including (what is now) the third major network provider, Sprint. Later, the
21 continued growth of the resale market resulted in the construction of the fourth
22 national network (WilTel) for the express purpose of providing wholesale carrier -
23 to-carrier services, as opposed to retail services, for use by the "resale" industry.

24 **Q. WILL THE RESALE OF WHOLESALE SERVICES AND ACCESS TO**
25 **NETWORK ELEMENTS SPUR NETWORK CONSTRUCTION?**

1 A. Yes. These tools are essential for local competition to proceed and to provide the
2 appropriate foundation for the network construction that will continue for the
3 indefinite future. The Department of Justice recently reached the identical
4 conclusion, noting in its comments to the FCC (Docket 96-98, page 37) that:

5 Reducing entry barriers into local markets by permitting resale [of
6 wholesale services] and cost-based access [to network elements] is
7 much more likely to lead to the greater development of facilities-
8 based competition than would occur absent such access and resale
9 opportunities.

10 It also should be recognized that the Act provides a strong, potentially threatening,
11 incentive for local network investment, that is, BellSouth becoming a long distance
12 company. This single action will transform BellSouth from the long distance
13 industry's principal *supplier* to its principal *rival*. Long distance companies will not
14 want to be as dependent upon BellSouth as they are today once BellSouth becomes
15 their main competitor. Each will construct, and encourage the construction by
16 others, of other networks in as short a time as possible.

17 **Q. DO YOU EXPECT CARRIERS WILL REPLICATE THE ENTIRE**
18 **BELLSOUTH NETWORK?**

19 A. No. It is likely that some portions of the network may never see a competitive
20 alternative, certainly in the next several years. For instance, it is easy to visualize
21 significant resistance on the part of residential homeowners to multiple network
22 interface boxes being installed on their premises to reflect previous, and future,
23 competitive choices in local services. Other elements of the network may best be
24 provisioned by a sole network vendor (for instance, the loop and local switching in
25 many areas). The point is not simply to encourage new construction -- the goal is to

1 encourage efficient facilities deployment. Wholesale services and correctly priced
2 unbundled network elements, that is to say economically priced unbundled network
3 elements, are key elements of this transition.

4 **III. LOCAL SERVICES RESALE**

5 **A. *The Role of Local Services Resale***

6 **Q. WHAT IS LOCAL SERVICES RESALE?**

7 A. Local services resale is the purchase of an incumbent LECs services by a competing
8 local service carrier on a wholesale basis with the intent to resell these services to
9 consumers. Wholesale local services are expressly designed, supported, and *priced*
10 to be resold by another carrier in the retail market. These wholesale local services
11 provide multiple entrants a simple means to begin offering local exchange services
12 and attract customers. BellSouth is required to offer its local services for resale at
13 wholesale rates under Section 251(c)(4) of the Act.

14 **Q. WILL LOCAL SERVICES RESALE PROVIDE IMMEDIATE CONSUMER**
15 **BENEFITS?**

16 A. Yes. In the long distance marketplace today, many carriers buy long distance
17 services at wholesale rates for purposes of reselling them to customers, and compete
18 by differentiating their billing systems, customer support and other elements of
19 services. This same strategy can be extended to the local marketplace, with carriers
20 using their marketing and customer skills to resell services obtained from the
21 incumbent LEC.

22 The utility of local services resale as a means to support broad entry has been
23 verified by the Rochester Telephone Company experiment. The Rochester
24 experiment is best known for exposing the importance of operational support
25 systems and the need for a viable discount. AT&T experienced a number of

1 problems attempting to offer local services on a mass market basis, and the
2 experimental 5% discount showed the importance of correct pricing. Ultimately,
3 AT&T had to stop soliciting customers until these problems could be corrected.
4 The deficiencies in the Rochester experiment are well documented and widely
5 understood. But there are other, more subtle lessons, from the Rochester experiment
6 that should not be overlooked. Foremost is that Rochester did prove the usefulness
7 of local resale as a way to enter a market quickly and offer customers a choice of
8 local providers. AT&T was able to offer service throughout the territory, while
9 other entrants remained confined to multi-tenant buildings. Equally telling,
10 however, is that the operational and pricing problems caused AT&T to terminate its
11 marketing, demonstrating that establishing conditions that will sustain competition is
12 just as important as permitting the entry itself.

13 **Q. WILL LOCAL SERVICES RESALE PROVIDE AN EFFECTIVE CHECK**
14 **ON BELLSOUTH'S PRICING?**

15 A. Only in small ways. Requiring BellSouth to provide wholesale local exchange
16 services will limit its ability to discriminate between classes of customers, except
17 where the Commission has blessed such discrimination to satisfy a unique public
18 need (such as, for instance, preventing lifeline services from being offered outside
19 the targeted class).

20 Wholesale services, however, will not police the overall level of rates as effectively
21 as the pricing of unbundled network elements and interconnection as discussed
22 earlier in this testimony. This is because the wholesale price is calculated off the
23 retail rate. As retail prices move up, so too do wholesale rate levels, and price
24 competition is constrained by the differential. As a result, only limited price
25 competition is made possible by reselling wholesale services. Thus, the need to

1 regulate BellSouth's retail rates remains unchanged.

2 **Q. SHOULD ALL RETAIL SERVICES HAVE A WHOLESALE**
3 **EQUIVALENT?**

4 A. Yes. There are a number of strategies that BellSouth could use to limit the
5 usefulness of the wholesale option. Several of the agreements which have been
6 reached recently -- importantly, with carriers that have little or no interest in
7 reselling BellSouth's services -- expose this strategy. In particular, BellSouth
8 proposed to AT&T the following exclusions to its wholesale pricing and resale
9 obligations:

- 10 - Grandfathered and Obsoleted services
- 11 - Promotional rates
- 12 - Contract Service Arrangements
- 13 - Installment Billing
- 14 - Special Billing Arrangements

15 Any *one* of these exclusions could be used by BellSouth to effectively evade its
16 wholesale obligation by selectively targeting customers for special pricing, rolling
17 promotions, and grandfathering, which is a more polite phrase for warehousing,
18 large sections of the market. Together, these exclusions could eliminate the
19 wholesale option as an entry option.

20 ***B. A Simple Model to Estimating Avoided Costs***

21 **Q. WHAT IS THE BASIC APPROACH TO CALCULATING THE**
22 **WHOLESALE PRICE FOR LOCAL SERVICES?**

23 A. The basic approach is to remove from the retail price an estimate of the retail-related
24 costs that will be avoided by BellSouth as a wholesaler of services.

25 **Q. WHAT WOULD OCCUR IF THE COMMISSION DOES NOT FULLY**

1 **REMOVE THESE RETAILING COSTS WHEN ESTABLISHING THE**
2 **WHOLESALE RATE?**

3 A. Failing to fully remove retail costs would create a wholesale rate level that is too
4 high. This would distort competition and artificially depress entry. The effect
5 would be to deny consumers the benefits of competition -- lower prices, more
6 choices and the ability to vote their dollar between rivals vying for their attention.
7 It is useful to remember that although the immediate recipient of a wholesale
8 discount is the local reseller, the ultimate beneficiaries are consumers. An
9 artificially low wholesale discount will not lead to lower retail prices. In other
10 words, the smaller the discount, the less competitive pressure to lower prices.

11 **Q. HAVE YOU DEVELOPED A SIMPLIFIED AVOIDED-COST**
12 **METHODOLOGY?**

13 A. Yes. I have developed a very simple model, based on BellSouth's publicly available
14 accounting data, to estimate the percentage of its costs that are retail-related. The
15 purpose of offering this model is to provide an independent check on the discounts
16 suggested by AT&T and BellSouth. While the model is simple, I believe that it
17 reasonably estimates BellSouth's retail-related costs, and is certainly adequate as a
18 validation tool.

19 **Q. PLEASE DESCRIBE YOUR MODEL.**

20 A. The model recognizes that BellSouth's cost accounts can be assigned into three
21 categories:

22 I. Retail-Only Accounts

23 This category consists of accounts that comprise costs that are *clearly* retail-
24 related. These accounts are customer operations marketing and customer
25 operations service, and include expenses such as marketing, sales, customer

1 services. Source: Source 1995 ARMIS 43-01 Customer
2 Operations/Marketing and Customer Operations/Service Expenses.

3 II. Mixed Accounts

4 This category consists of accounts that mix costs that are retail-related with
5 expenses that are not. For example, this category includes the expenses
6 associated with functions such as executive planning, accounts and finance,
7 and external relations. (Source: 1995 ARMIS 43.01 Corporate Operations
8 Expenses). Obviously, some portion of these expenses are directly caused
9 by retailing activity, but the accounting system does not identify the retail-
10 related portion separately.

11 III. Non-Retail Accounts

12 This category consists of all accounts not assigned to categories I or II
13 above.

14 Before proceeding, I acknowledge that even the categories that are identified as
15 exclusively retail (or non-retail) may be slightly contaminated. Attempting to chase
16 every penny, however, is not the point. Just as there may be some non-retail costs in
17 a retail-category, there are surely retail-costs in the category considered non-retail in
18 nature. For example, the simple model treats *all* depreciation expenses as non-retail
19 even though there are obviously retail-related assets being depreciated, such as, for
20 example, the desk and office of the director of marketing. The point is that the
21 imprecision of the simple model works both ways and, as a result, is likely to yield
22 an unbiased estimate.

23 The relatively easy issue is identifying the accounts that are exclusively one thing or
24 the other. The more difficult issue is determining the *portion* of the expenses in the
25 mixed category that should be considered retail-related.

1 **Q. HOW DOES THE SIMPLE MODEL ESTIMATE THE RETAIL-PORTION**
2 **OF THE MIXED CATEGORY?**

3 A. The model uses a statistical technique (linear regression) to estimate the relationship
4 between the level of expenses in the mixed category (corporate expenses) and retail
5 revenues (revenues less access) using 1995 actual data for the nine BellSouth states.
6 This relationship then is used to estimate the level of corporate expenses that would
7 occur even if no retail revenues existed. When these "unavoidable" corporate
8 expenses are subtracted from the actual amount, the remainder is the "avoidable"
9 amount attributable to retail activity.

10 The approach is graphically depicted in Figure 1 (attached as Exhibit JPG-2).
11 Figure 1 shows that the "modeled" relationship (the line in Figure 1) closely predicts
12 the actual data (depicted as squares). In fact, the "correlation" in the model is 90%
13 (a perfect "fit" would be 100%).

14 **Q. WHAT WHOLESALE DISCOUNT IS SUGGESTED BY THE SIMPLE**
15 **MODEL?**

16 A. The simple model provides a estimated wholesale discount of just over 39% (39.4%
17 to be exact). This discount is the sum of the retail-only accounts and the portion
18 (from the above analysis) of the mixed-accounts that are associated with retail
19 activity, divided by retail sales. This simple approach provides independent
20 confirmation that the discount estimated by AT&T Witness Lerma's more
21 sophisticated model (41.7%) is reasonable.

22 **Q. ARE THERE OTHER STANDARDS TO JUDGE THE REASONABLENESS**
23 **OF THE PROPOSED DISCOUNTS?**

24 A. Yes. In the long distance market there is a competitive wholesale market that
25 actively solicits retail carriers with attractive wholesale pricing and operational

1 systems specifically designed for resale. It is useful to consider the discounts that
2 the RBOCs have trumpeted to Wall Street analysts to place the local wholesale
3 discounts discussed in this proceeding into context.

4 For instance, NYNEX recently indicated to Wall Street analysts that it anticipated a
5 80% discount on the long distance services it buys at wholesale. (Source: Dean
6 Witter, November 6, 1995.) Further, Merrill Lynch (Merrill Lynch, August 24,
7 1995) states:

8 ... reseller spreads in long distance are already huge (50%) given the
9 existence of four fiercely competitive long distance networks.

10 Merrill Lynch also predicts that:

11 For calls terminating outside an individual RBOC's franchise area,
12 that RBOC will be able to bargain for volume discounts given that
13 its volumes are likely to exceed that of any other long distance
14 customer in that region -- *discounts that are likely to grow over time*
15 *as RBOC long distance shares and thus negotiating leverage grows.*

16 Emphasis added.

17 The point here is simple: where *competition* decides the wholesale discount, that
18 discount is large and is expected to increase.

19 *C. The Dilutive Effect of Access Charges on the Wholesale Discount*

20 **Q. DO YOU BELIEVE THAT THE DISCOUNT ESTIMATED BY AT&T WILL**
21 **BE SUFFICIENT TO FOSTER LOCAL ENTRY?**

22 A. No. Even though a discount of this level would apparently comply with the
23 avoided-cost standard of the Act, the Commission should be aware that the interplay
24 between local resale and access service (i.e., the charges BellSouth imposes on long
25 distance companies) will significantly reduce the viability of local resale. This is

1 because BellSouth would continue to charge a reseller-entrant carrier access
2 charges, even to originate or terminate traffic to the reseller's own customers. As
3 explained below, this arrangement diminishes the attractiveness of local resale.

4 **Q. PLEASE DESCRIBE THE RELATIONSHIP BETWEEN ACCESS**
5 **CHARGES AND THE WHOLESALE PRICES.**

6 A. With local resale, BellSouth remains the access provider even to the customers that
7 have "left" and become customers of the reseller. Because access charges are priced
8 above cost, BellSouth is able to retain much of the profits from a customer, even
9 after it has lost its retail business. In effect, this means that the reseller markets the
10 relatively less profitable service (local service), while BellSouth retains the cream
11 (access service). This situation is somewhat analogous to agreeing with Gillette to
12 market its razor handles, while Gillette retains a monopoly on the blades. Sound
13 competition cannot proceed on this basis.

14 **Q. WHAT IS THE EFFECT OF BELL SOUTH'S RETAINING AN ACCESS**
15 **MONOPOLY TO THE RESELLER'S CUSTOMERS?**

16 A. One way of measuring the impact of this arrangement is to calculate an "effective"
17 wholesale discount that not only considers what the interexchange carrier/local
18 reseller pays for the wholesale local exchange service, but also includes the access
19 charges that the interexchange-carrier/local-reseller continues to pay BellSouth.
20 This "effective" discount can then be compared to the nominal discount; i.e., the
21 discount that considers only the price paid for the wholesale local exchange service.
22 When access charges are included in the equation, the effective discount is reduced
23 substantially. For instance, if the nominal discount is 50%, BellSouth does not
24 receive 50% less revenue for each customer that moves to a reseller because it
25 continues to receive access revenues. For the *average* customer, if the nominal

1 discount is 50% the effective discount is only 24%. This comparison understates the
2 effect of access, however, since it is calculated for the average customer. The
3 dilutive effect increases as the average toll usage of the reseller increases because
4 higher toll users cause higher access charges to be paid by the long distance carrier
5 to the incumbent LEC. Consequently, even when nominal wholesale discount levels
6 appear large, the realized differential remains relatively small once access charges
7 are taken into consideration.

8 The magnitude of this problem should not be underestimated. For the purpose of
9 comparison, consider the combined effect of a 40% wholesale discount (as
10 suggested by AT&T) and current access charges. On average, the reseller would
11 gain approximately \$9.00 for each subscriber line it attracted, while BellSouth
12 would retain approximately \$^{15.00}5.00 per month in access revenues, even from the
13 customers that it lost.

14 No matter how diligently the Commission removes retail-related costs from
15 BellSouth's wholesale prices, the above-cost pricing of access will distort a reseller's
16 ability to compete with BellSouth. BellSouth recovers its costs in the price of *both*
17 local/retail service and access service, while its competitors must recover all their
18 costs solely through the wholesale discount. As the Department of Justice noted
19 (CC Docket No. 96-98, page 39):

20 The economics of a competitive [local] marketplace would not
21 support entry solely on the revenues derived from local exchange
22 service.

23 Similarly, local competition based on the resale of wholesale services will not
24 succeed so long as the access charges which the local exchange carrier continues to
25 receive from the reseller are a principal source of local profit. Real competition

1 requires that both the entrant and incumbent face the same cost for the facilities used
2 to provide service and have the same opportunity to recover those costs.

3 **Q. HOW CAN THE COMMISSION CORRECT THE DISTORTION CAUSED**
4 **BY THE ABOVE-COST PRICING OF CARRIER ACCESS?**

5 A. The Commission has two choices. First, the Commission can correctly price access
6 charges so that the source of the distortion is eliminated. As I noted earlier, the
7 competitive environment that the Act intends to ultimately achieve cannot occur
8 unless all carrier-to-carrier arrangements are cost-based and non-discriminatory,
9 including access service. Consequently, addressing access pricing head-on would,
10 in my view, be the preferred approach. In the absence of access reform, however,
11 an alternative approach would be to increase the wholesale discount to recognize
12 that access revenues are retained by the incumbent. In no event should the discount
13 fall below the level justified by the avoided cost.

14 **IV. UNBUNDLED NETWORK ELEMENTS**

15 ***A. The Nature of Unbundling***

16 **Q. PLEASE DEFINE “UNBUNDLING.”**

17 A. Unbundling refers to the offering of discrete elements of the incumbent's network as
18 generic functionalities, not as finished services. These network elements are
19 “unbundled,” both from each other and from the retail services of the incumbent
20 LEC.

21 A useful metaphor for unbundling is that of the “Chinese Restaurant.” Chinese
22 restaurants typically have extensive menus, detailing dozens of selections. Yet, in
23 the kitchen, only a few basic ingredients are used to create all these choices.
24 Similarly, telecommunications services are typically constructed from a limited
25 number of key ingredients (switching and transmission are the most basic), but the

1 variety of services (from the consumer's perspective) can be quite extensive.
2 Unbundling represents the availability of the incumbent's network elements as
3 ingredients to other providers so that they may combine these ingredients
4 (sometimes adding their own, sometimes not) to provide their own finished services.

5 **Q. IS UNBUNDLING THE SAME AS RESALE?**

6 A. No. Resale involves the purchase of *finished services* by the reseller from the
7 incumbent LEC (albeit at wholesale rates) which are then resold by the reseller.

8 Unbundling is the purchase of underlying *network elements* -- which may be
9 facilities, functions or capabilities -- that can be combined to offer services, either
10 equal to, or different from, the services of the incumbent LEC.

11 **Q. WHAT ARE THE POTENTIAL BENEFITS FROM UNBUNDLING?**

12 A. There are three primary benefits. First, opening the incumbent's network to other
13 carriers as a menu of generic ingredients will make robust competition possible
14 despite the dominance, if not complete monopoly, of the incumbent LEC's network.

15 New entrants could fashion service packages not now available, providing
16 consumers additional choices.

17 Second, unbundling allows carriers to sequentially replace individual components of
18 BellSouth's network as competitive networks slowly develop. The enormity of
19 BellSouth's network necessarily implies that the process of facilities deployment
20 will take time, and will occur unevenly throughout its region. However, through
21 unbundling, carriers will have an opportunity to develop markets, establish services,
22 and attract consumers on a timely basis in the *entire* market, with the process of
23 facilities-deployment following wherever economic.

24 Third, with unbundling there will be substantially more choices at the end of the
25 process than would result if each individual entrant had to construct network

1 facilities in order to offer services. Unbundling prevents local network deployment
2 from becoming a prerequisite to offering service, both for today's entrants and new
3 providers that may form in the future. By creating an open entry environment,
4 investment capital can be directed to developing new services and applications,
5 rather than used exclusively to replicate transmission and switching facilities. By
6 reducing, and then keeping, barriers to entry low, the most diverse competitive
7 environment will develop.

8 Thus, unbundling has the potential for *immediate, transitional and long lasting*
9 benefits for the market and Florida consumers. What matters most at the end of the
10 process is that multiple carriers have the opportunity to broadly approach the Florida
11 marketplace, designing services which they believe best satisfy the needs of their
12 customers, on an economic basis similar to that of the incumbent LEC, and fully
13 supported by operational systems which will easily accommodate choices by
14 consumers.

15 A full description of the most fundamental elements that should be unbundled
16 immediately is identified in the testimony of AT&T Witness James Tamplin.

17 ***B. Network Element Pricing***

18 **Q. HOW SHOULD NETWORK ELEMENT PRICES BE ESTABLISHED?**

19 A. Network element prices set at direct economic costs will yield the greatest choice
20 and benefits to Florida consumers. To maximize competition -- that is, to promote
21 an environment that will present Florida consumers with the greatest diversity of
22 pricing plans, calling options, and service features -- it is important that the
23 underlying exchange network be available to *all* retail providers of local exchange
24 services on the same terms, conditions and prices.

25 There are only two ways to assure that all providers have access to the exchange

1 network on equivalent terms. The first is to prohibit the network owner from
2 offering competitive services at all. This was the basic approach that underlaid
3 divestiture; for obvious reasons I am not recommending that action here.
4 In the absence of such structural protection, the only viable mechanism is to
5 establish prices of the underlying network components at their economic resource
6 cost. The key is to make the network available to all providers on equivalent terms.
7 For the incumbent LEC, this is the element's economic cost, i.e., its total service
8 long run incremental cost ("TSLRIC"). So that all providers face the *same* effective
9 cost for the use of a network component, the *price* charged other carriers must be
10 equal to the economic *cost* of the element in question. Dr. Kaserman's testimony
11 provides additional details concerning the appropriateness of TSLRIC pricing for
12 network elements.

13 **Q. DOES PRICING NETWORK ELEMENTS AT TSLRIC IMPLY THAT**
14 **BELLSOUTH WOULD NOT BE ALLOWED TO EARN A PROFIT OR**
15 **COVER ALL OF ITS COSTS?**

16 A. No. First, economic pricing includes a return on investment sufficient to attract and
17 retain capital. Although commonly referred to as "profit," the "cost of capital" is a
18 legitimate economic cost and is included in TSLRIC.
19 Second, the economic cost of network elements would include costs associated with
20 planning, engineering and operating BellSouth's network, including costs which are
21 shared by more than one network element (such as the salary of the Operations
22 Director). In the context of retail services, these costs would be viewed as
23 "common," and would not be included in the economic cost of any particular
24 service. Because of this historical context, the Commission may mistakenly assume
25 that the economic costing of network elements would leave a number of "costs"

1 unrecovered.

2 Importantly, however, perceptions concerning common costs derived in an
3 environment of *retail* costing are not applicable to the costing of *network elements*.
4 For example, consider the salary of a switch technician. In a typical *retail* cost
5 analysis, this cost would be considered common to each of the BellSouth's retail
6 services that rely (to one extent or another) on the use of local switching. Yet, when
7 calculating the cost of the local switching *element*, the technician's salary is a direct
8 cost and is included in TSLRIC.

9 Finally, there is a category of common costs -- the costs associated with product
10 development, marketing, and advertising that support BellSouth's retail operations,
11 as well as financial and managerial costs, that would be incurred whether BellSouth
12 owned and managed its network or not. These have no relevance to the costing of
13 network elements because these costs are not incurred to provide network functions.
14 However, this does not mean that these costs will go unrecovered. It only means
15 that BellSouth must be as efficient as its rivals, who must also recover these costs in
16 the prices of their services.

17 **C. Access and Local Call Termination**

18 **Q. ARE ACCESS AND CALL TERMINATION IDENTICAL?**

19 A. Yes. The functionality to terminate a call is the same whether the call is classified
20 as a "local" call or a "long distance" call. A pricing issue arises, however, because
21 the charges to long distance carriers to terminate toll traffic (i.e., access) are far
22 above cost.

23 **Q. WHY ARE CALL TERMINATION PRICES SO IMPORTANT?**

24 A. The prerequisite to any form of telecommunications competition is the ability to
25 complete calls to other subscribers, virtually all of whom (within BellSouth's

1 exchanges) are served by BellSouth's network. In this regard, the introduction of
2 local competition is not unique. Whether a call is labeled local, or long distance, it
3 still must be terminated to the customer.

4 **Q. WHY IS IT IMPORTANT THAT RATES FOR TRAFFIC TERMINATION**
5 **BE THE SAME FOR "LOCAL" AND "LONG DISTANCE" TRAFFIC?**

6 A. One of the potential benefits of full service competition is competitively determined
7 "local" calling areas. In a competitive market, the "local" calling area should
8 become an important dimension of product differentiation, with carriers offering a
9 variety of price and boundary packages to consumers.
10 For BellSouth to charge a different price for terminating "long distance" calls and
11 "local" calls, BellSouth would need to require that all competitors adopt the same
12 definition of local calling *and* BellSouth would need to implement auditing systems
13 to correctly assess its charges. Such systems are not only unnecessary, but they
14 would be used solely to accomplish an unreasonable result -- the continued
15 discrimination between local and long distance calling, and to maintain the payment
16 of access charges far above costs to the incumbent LEC.
17 The preferable approach is to establish non-discriminatory termination rates that do
18 not attempt to differentiate between types of calls. In this way, carriers would be
19 free to decide the scope of their own local calling areas, sizing these areas to match
20 their own perception of the market and to reflect their own pricing and marketing
21 strategies. In this way, the market -- which is to say, *consumers* -- will decide the
22 size and shape of the local calling area as carriers compete along this important
23 dimension of service.

24 **Q. DOES BELL SOUTH AGREE THAT INTERCONNECTION PRICES**
25 **SHOULD BE NON-DISCRIMINATORY?**

1 A. Yes. In BellSouth's Comments to the FCC on these same issues (CC Docket No.
2 96-98, page 63), BellSouth recommends that:

3 The [Federal Communications] Commission should take a
4 comprehensive view leading to a common model for
5 interconnection that is not based on classification of carriers as
6 LECs, IXCs, CMRS providers, or ESPs.

7 Similarly, this Commission should implement a comprehensive cost-based pricing
8 system which does not discriminate between types of calls or carriers. To the extent
9 that some portion of today's access rates are needed to subsidize particular
10 consumers or services, then that subsidy should be specifically identified and
11 explicitly recovered through a competitively neutral universal service fund.

12 **Q. IF TERMINATING LOCAL CALLS AND TERMINATING LONG**
13 **DISTANCE CALLS ARE IDENTICAL, WHY SHOULDN'T THE**
14 **COMMISSION APPLY ACCESS CHARGES TO LOCAL CALLS?**

15 A. The problem is that access charges are significantly inflated over cost. Using these
16 inflated charges to establish charges for local termination would simply adopt a
17 "poison both wells" pricing strategy. While the services might be equivalent, the
18 consequences from the excessive rate levels would not be.

19 Long distance competition has survived despite high access prices for two reasons.
20 First, incumbent LECs could not provide long distance services and, as a result,
21 retail price levels reflected that all providers faced the same (albeit high) cost for
22 this input. Second, long distance prices and access charges are both measured.
23 Therefore, access costs and revenues both grow or diminish with traffic volumes.
24 Neither of these conditions holds true in the local exchange marketplace. Entrants
25 will have to compete with BellSouth on day one, and BellSouth's cost to offer local

1 service is the economic cost of network usage, not the access charge. Second, local
 2 exchange prices in Florida are flat-rated, and imposing on BellSouth's rivals a cost-
 3 structure directly at odds with retail rates will place them at a disadvantage when
 4 serving consumers with relatively high local calling patterns.

5 **Q. HOW SHOULD THE COMMISSION ESTABLISH LOCAL CALL**
 6 **TERMINATION RATES UNTIL IT IS ABLE TO CORRECTLY**
 7 **ESTABLISH ACCESS CHARGES?**

8 A. The Commission should establish cost-based termination rates for local traffic as
 9 outlined in AT&T Witness Ellison's testimony. and require that such charges be
 10 reciprocally applied. These cost-based termination charges should then become the
 11 target rate levels for all access services. In the interim, the Commission should rely
 12 on a bill and keep system.

13 **V. OPERATIONAL BARRIERS TO**
 14 **ACHIEVING CUSTOMER CHOICE**

15 **Q. HOW DO OPERATIONAL ISSUES AFFECT CUSTOMERS AND THEIR**
 16 **ABILITY TO BENEFIT FROM LOCAL COMPETITION?**

17 A. There are two ways that operational questions directly will impact consumer
 18 perceptions concerning local competition. In order for local competition to be
 19 viewed as a success:

- 20 * it must be easy for *consumers* to change local carriers, at least as easy as the
- 21 PIC-change process they are now familiar with, and
- 22 * it must be easy for *carriers* to serve consumers quickly and with a minimum
- 23 of network disruption.

24 Only if these conditions are satisfied will the market changes contemplated by the
 25 Act roll out smoothly in the eyes of consumers.

1 *A. Supporting Customer Choice*

2 **Q. WHY IS IT IMPORTANT FOR OPERATING SYSTEMS TO BE ABLE TO**
3 **EASILY ACCOMMODATE CONSUMER CHOICES?**

4 A. When the Act is fully implemented, today's familiar separation between local and
5 long distance companies will be replaced with many consumers choosing a full
6 service provider for both their local and long distance needs. A primary motivation
7 for full service (i.e., one-stop shopping) competition will be convenience. This may
8 seem obvious, but the benefits of full service competition cannot be realized if
9 *moving* to a full service provider is inconvenient and disruptive.
10 With this in mind, it is useful to compare the relative ease and convenience that
11 consumers would experience when choosing between BellSouth and any other full
12 service provider, including their existing long distance carrier. This is the most
13 relevant comparison, because these carriers today share the *same* customer base and
14 thus are most likely to approach these customers with the goal of becoming their full
15 service provider.

16 **Q. ARE THE EXISTING PROCESSES USED TO IMPLEMENT CONSUMER**
17 **CHOICES AMONG LONG DISTANCE PROVIDERS AT ALL**
18 **COMPARABLE TO LOCAL SERVICES?**

19 A. No. The process used to transfer a customer to a new long distance company, the
20 PIC-change process, is automated, inexpensive and sized to handle large demands.
21 Significantly, it is also well tested, having been used for more than a decade,
22 through countless product introductions, advertising campaigns, and marketing
23 initiatives. In contrast, the "process" used to change local providers is unknown
24 and, in any environment where a physical circuit rearrangement is necessary,
25 inherently more complicated and problematic.

1 One measure of comparison is the charge imposed on a customer selecting between
2 two full service providers -- its existing local exchange carrier now offering long
3 distance services, and its long distance carrier now offering local services. If a
4 customer leaves its long distance carrier to obtain a full service package from
5 BellSouth, BellSouth would charge \$1.49 per line (the PIC-change fee).
6 Conversely, under the agreement BellSouth recently announced with ICI, if the
7 same customer shifted its local service to its long distance carrier for a full service
8 package, BellSouth would impose a non-recurring charge of \$140.00 just for the
9 unbundled loop. If other network elements are needed (and, in most cases, they
10 would be) this non-recurring charge would increase.

11 **Q. WHAT MUST OCCUR FOR COMPETITION TO SUCCEED?**

12 A. Consumers must be able to move between local service providers with the same
13 ease that they now move between long distance carriers. This is necessary both for
14 consumers to perceive this market change as beneficial, and to assure that both local
15 and long distance carriers have a fair opportunity to become the consumer's full
16 service provider.

17 Second, however, a PIC-like customer migration process must be available both for
18 local services resale *and* the unbundled network element approaches. Without the
19 ability to honor customer changes inexpensively, the network element option could
20 only be used to serve selected customers and the advantages of this option would be
21 limited to the few.

22 ***B. Ordering Combinations of Unbundled Network Elements***

23 **Q. HOW CAN UNBUNDLED NETWORK ELEMENTS BE USED TO PROVIDE**
24 **LOCAL SERVICES WITH THE LEAST DISRUPTION TO CONSUMERS?**

25 A. In order for consumers to benefit from competition, carriers must be able to easily

1 obtain and configure the unbundled network elements that they will use to provide
2 services. The key to rapid competition and easy customer choice is the ability of
3 entrants to provide service using unbundled local switching, frequently in
4 combination with other elements. With unbundled local switching, customers can
5 be moved between different providers without physically reconfiguring the service
6 to the customer.

7 **Q. CAN THE UNBUNDLED LOOP, BY ITSELF, PROVIDE THIS**
8 **FLEXIBILITY?**

9 A. No. Unbundled loops, while important, are unlikely to support broad-scale, mass-
10 application, entry into the local services market.

11 First, the unbundled-loop configuration is viable only where a collocated network
12 exists. Even where these networks are economically attractive, they now do not
13 exist and it will take time for them to be constructed and made operational.

14 Second, and more permanently, the unbundled-loop configuration easily cannot
15 effect large changes in market share between alternative providers because physical
16 changes in the network will be necessary -- i.e., the actual loop to the customer must
17 be reconfigured from BellSouth's local switch to a competitor's every time a
18 customer changes a local service provider.

19 As a result, unbundled loops (by themselves) are unlikely to foster a fully
20 competitive environment. Instead, carriers will need to order combinations of
21 network elements, typically involving unbundled local switching, to provide
22 competitive services to consumers.

23 **Q. HOW WILL CARRIERS BE ABLE TO MOVE CUSTOMERS MORE**
24 **RAPIDLY USING UNBUNDLED LOCAL SWITCHING?**

25 A. The answer is using the network to move customers without manual changes in the

1 physical connections to these customers. This condition is satisfied by a network
2 configuration which combines several network elements, including local switching,
3 to provide service. Customers can easily change among local carriers who are
4 providing services using the incumbent LEC's unbundled local switching element,
5 because the customer's lines need not be reconfigured to a different switch for
6 service. This arrangement is sometimes referred to as the "platform" configuration.

7 **Q. WHAT IS THE "PLATFORM" CONFIGURATION?**

8 A. The platform configuration is the combined purchase of unbundled switching and an
9 unbundled loop (frequently in combination with transport and signaling) to form a
10 basic exchange platform to offer local exchange and exchange access services. The
11 critical element is correctly defining unbundled local switching to enable the new
12 entrant to: (a) activate (more precisely, to *order* that the incumbent LEC activate)
13 the various features on the customer's loop that defines its local services, (b) define
14 traffic routing as alternative networks become available (although, initially, it is
15 likely that local traffic would be terminated using the incumbent LEC's network),
16 and (c) create the records to bill the end-user for local exchange service and other
17 carriers for exchange access and interconnection service. By providing services
18 using a combination of unbundled loops and switching, several of the operational
19 barriers presented by utilizing unbundled loops alone can be overcome. Again, the
20 basic definition of unbundled local switching is provided in more detail in the
21 testimony of AT&T Witness James Tamplin.

22 **Q. HOW DOES THIS CONFIGURATION OVERCOME THE LIMITATIONS**
23 **ASSOCIATED WITH THE UNBUNDLED LOOP ELEMENT DESCRIBED**
24 **EARLIER?**

25 A. First, the platform configuration efficiently uses the existing network to obtain

1 switching and call termination. As a result, its value is not artificially limited to
2 central offices where a carrier has established a collocated network node, nor does it
3 require a duplication of BellSouth's preexisting interoffice and local switching
4 matrix as a prerequisite to entry.

5 Second, customers can easily shift between local providers using the platform
6 configuration because the existing exchange line does not need to be reconfigured to
7 provide service. Because the underlying facility arrangement is unaffected,
8 operational systems should be able to accommodate market changes with an ease
9 comparable to the PIC-change process used in the long distance industry.

10 Third, one of the benefits of the platform configuration is that it solves (at least
11 temporarily) the entry barrier presented by the absence of number portability.

12 Because the new entrant's customers would continue to be served by the incumbent's
13 local switch, there is no need for consumers to change phone numbers as they move
14 between local providers.

15 **Q. ARE THERE OTHER BENEFITS FROM THIS ARRANGEMENT?**

16 A. Yes. The platform approach provides every carrier an ability to design its own
17 services, constrained only by its own imagination and the inherent ability of the
18 network. Unbundled local switching enables a carrier to purchase switching
19 capacity as a generic ingredient and then determine which features and capabilities
20 of the switch it will offer as part of its finished local services. The advantages of
21 this approach will become even more pronounced as the "Advanced Intelligent
22 Network" ("AIN") call processing model is introduced.

23 AIN uses a system of "triggers" to access remote databases for call processing
24 instruction. For instance, the "off-hook trigger" automatically suspends call
25 processing at the switch when the customer lifts its receiver. The trigger then

1 queries a service control database for additional instructions. One way of looking at
2 AIN is that it takes the *intelligence* out of the network switch, and uses the switch
3 simply to execute call processing. In an AIN environment, each entrant will be able
4 to define unique new services for their particular customers, even if they all use the
5 same local switch to provide dial-tone and provide the first point of switching.
6 In addition, the platform configuration allows each carrier the flexibility to provide
7 its own local exchange services to end-user customers, and exchange access services
8 to other carriers, achieving the same status and opportunities as any other local
9 telephone provider. Competition across all prices and services would then be
10 possible.
11 Of course, as noted at the beginning of this Section, none of these benefits are
12 possible unless consumers are able to easily implement a choice in carriers. That is
13 why it is so important to implement the operating systems that are described further
14 in the testimony of AT&T Witness James Tamplin.

15 VI. SUMMARY

16 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

17 A. The Commission's decision in this proceeding may be the most significant in its
18 history as a regulator of telecommunication services. The Act has the potential of
19 bringing substantial competitive benefits to Florida consumers, providing them, for
20 the first time, direct say in the services they are offered through the power of choice.
21 Realizing these benefits, however, can occur only if the entry tools described in the
22 Act become practical, working vehicles that entrants may use to provide that choice.
23 This, in a sentence, is the fundamental objective of this arbitration -- to provide
24 AT&T (and other entrants) the tools they will need to provide local exchange
25 services in competition with BellSouth. That AT&T's request encompasses the full

1 range of entry tools provided by the Act increases the complexity of the proceeding,
2 but it also promises to provide greater and broader benefits than the limited requests
3 that have come before the Commission to date.

4 What do entrants need? Simply this: the ability to resell wholesale equivalents of
5 BellSouth's retail services at wholesale rates; the ability to purchase and combine a
6 core list of unbundled network elements, correctly priced at economic cost; and the
7 ability to terminate traffic at cost-based, reciprocally applied, charges. Each
8 supported by an operational infrastructure designed for a multi-vendor local
9 marketplace. This is what the Act provides for, this is what the entrant is entitled to,
10 and this is what the Commission must see gets implemented.

11 Why? First and most obviously, to give consumers choice. But also, because the
12 Act portends BellSouth's eventual entry into the long distance market. There,
13 BellSouth will have access to wholesale long distance services and network
14 elements at competitive prices. There, BellSouth will find an operational
15 infrastructure specifically designed to support a multi-vendor market, including
16 systems to easily implement customer choices. In short, BellSouth will find the long
17 distance equivalent to all that the Act now requires that BellSouth offer others.

18 The Commission has long recognized its role as a surrogate for competition.
19 Historically, this role has been limited to the retail market. However, under the Act,
20 the Commission's role as a competitive surrogate shifts to the wholesale level,
21 because it is there that BellSouth's network monopoly poses the greatest risk. The
22 Commission's role now includes making this network available so that multiple
23 carriers may use it to offer retail services to consumers.

24 It is this final linkage to consumer prices that the Commission should not lose sight
25 of as it approaches the issues in this arbitration. Establishing the correct carrier-to-

1 carrier arrangements is complex, but, again, the ultimate beneficiaries will be
2 Florida consumers.

3 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

4 **A. Yes.**

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**SUPPLEMENTAL TESTIMONY OF
JOSEPH GILLAN
ON BEHALF OF AT&T COMMUNICATIONS OF
THE SOUTHERN STATES, INC.
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION**

Docket No. 960833-TP

Filed: August 23, 1996

INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando, Florida 32854.

Q. IS THIS TESTIMONY SUPPLEMENTAL TO YOUR PRIOR DIRECT TESTIMONY IN THIS MATTER?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENTAL TESTIMONY?

A. The purpose of this supplemental direct testimony is to explain the impact of the Federal Communications Commission's ("FCC") Rules implementing Sections 251

1 and 252 of the Act on the policy prescriptions and recommendations contained in my
2 prior direct testimony to this Commission. First Report and Order, Federal
3 Communications Commission, CC Docket 96-98, August 8, 1996 ("FCC Order").
4

5 The recent FCC regulations provide additional detail concerning this Commission's
6 role deciding the fundamental issues in this arbitration:
7

- 8 • Which network elements should be provided immediately;
- 9
- 10 • What cost standard should apply to their pricing;
- 11
- 12 • Which services should be resold at wholesale rates;
- 13
- 14 • How the wholesale price differential should be calculated; and
- 15
- 16 • What standards should be used to judge the adequacy of operational support
17 systems.
- 18

19 The FCC Order moves the Act one step closer to implementation. However, it will be
20 this Commission's resolution of the issues that actually determine the choices that
21 Florida consumers face, and the prices that they pay.
22

23 **Q. ARE THE RECOMMENDATIONS IN YOUR DIRECT TESTIMONY**
24 **CONSISTENT WITH THE FCC'S RULES?**

1

2 A. Yes, in virtually every respect. Overall, the FCC's rules reflect the Act's intention to
3 rapidly open local markets to competition through the implementation of the principle
4 that the incumbent's network should be available to new entrants on terms that are
5 non-discriminatory when judged against the use of this network by the incumbent
6 itself. This principle of non-discrimination is given effect through rules requiring that
7 the price of carrier-to-carrier network arrangements be based on economic cost and
8 the requirement that operational support systems -- the systems which support
9 ordering, provisioning, billing and maintenance -- provide entrants access to network
10 elements on the same basis that network elements are used by BellSouth to provide its
11 own services.

12

13 In one respect, however, the FCC departed dramatically from these principles with its
14 adoption of an interim surcharge that it will permit the incumbent LECs to impose on
15 purchasers of the unbundled local switching element. 47 C.F.R. § 51.515(b). This
16 temporary surcharge will last no later than June 30, 1997, but while it is in effect, the
17 usefulness of unbundled local switching to provide competing local exchange services
18 is drastically reduced. The FCC rules also provide the states the *option* of adopting a
19 similar interim plan. 47 C.F.R. § 51.515(c). Such a plan is unnecessary and is likely
20 to lead only to fewer choices to consumers and/or higher consumer prices. The
21 Florida Commission should not adopt a transitional surcharge mechanism.

22

23 **The FCC Rules Are Consistent with the Direct Testimony**

24

25 Q. PLEASE SUMMARIZE THE POLICY RECOMMENDATIONS

1 **CONTAINED IN YOUR DIRECT TESTIMONY.**

2

3 A. My direct testimony contained a number of policy conclusions and specific
4 recommendations. To summarize, the testimony concluded that:

5

6 • The fundamental intention of the Act is that local markets become
7 competitive, not just for selected customers in certain metropolitan areas, but
8 broadly throughout a state. The only way that ubiquitous competition can
9 become a reality, however, is if the existing BellSouth network is available
10 for other competitors to use in providing local exchange and exchange access
11 services. This is the core objective of the arbitration: to establish the terms,
12 conditions and prices under which BellSouth's network and services will be
13 available to rivals, including AT&T.

14

15 • The principal mechanism available to the Commission to influence the prices
16 and choices experienced by *consumers* is through its role establishing the
17 prices and choices available to *carriers*. Under the price cap regulatory
18 system that BellSouth has elected, this Commission's authority to directly
19 establish consumer-prices is severely restricted. The principal path to
20 consumer protection is choice -- choice among competing providers that are
21 able to offer services with equal quality and comparable prices to those of the
22 incumbent local telephone company.

23

24 • The pricing rules under which carriers obtain the use of the incumbent's

1 network and services provide the foundation for competition for end-users.
2 Where the entrant purchases the network functionality or facility underlying a
3 service, the price of these elements should be their economic cost. Where a
4 carrier purchases a wholesale service, the price of the wholesale service
5 should be calculated by fully removing retail-related costs. Only under these
6 pricing rules will entrants have the ability to broadly approach the market and
7 provide the choice of local service provider described above.

8

- 9 • A competitive local environment requires operational support systems that
10 enable entrants to translate these new carrier-to-carrier arrangements into end
11 user services and easily implement a consumers' decision to change its local
12 service provider without extensive delays or unnecessary costs.

13

14 Each of these core conclusions is reflected in the rules adopted by the Commission.

15

16 **Q. WHAT SPECIFIC AREAS OF YOUR DIRECT TESTIMONY WERE**
17 **ADDRESSED IN THE FCC'S RULES?**

18

19 **A.** The FCC rules addressed the following areas of my direct testimony:

20

21 1. The scope of BellSouth's obligation to permit the resale of its local exchange
22 services at wholesale rates and the methodology to calculate wholesale rates.

23

24 2. The appropriate economic costing standard for the pricing of network

1 elements and interconnection.

2

3 3. The appropriate economic costing and pricing standard for the transport and
4 termination of "local" traffic.

5

6 4. The need to establish operational systems that accommodate customer choice
7 and enable entrants to provide service using unbundled network elements and resale.

8

9 5. The ability to combine network elements to form exchange platforms to offer
10 local exchange and exchange access services.

11

12 In the testimony which follows, I explain how each of the recommended policies
13 contained in my prior direct testimony is either required by, or consistent with, the
14 FCC's rules. These rules, when fully implemented, will provide the foundation for the
15 competition that lies at the heart of the Act and my earlier testimony.

16

17 Before beginning, however, it is useful to place the FCC's rules and this arbitration
18 into perspective. Although the FCC's rules provide additional detail concerning this
19 Commission's role under the Act, these rules in no way diminish the importance of the
20 decisions that will be reached here. This Commission is charged with translating this
21 basic framework into a system of carrier-arrangements that will decide the choices
22 and prices faced by Florida consumers. Thus, while the rules clarify that BellSouth's
23 obligations under the Act, it is this Commission that will establish the prices and
24 specific terms that will make local competition a reality.

25

1 Q. HAVE THE FCC'S RULES REQUIRED ANY CHANGES IN YOUR
2 ORIGINAL RECOMMENDATIONS?

3

4 A. Yes. The one area of my direct testimony which the FCC's rules apparently preclude
5 is the suggestion in my direct testimony that the Commission adjust the wholesale
6 discount to correct for the above-cost pricing of access service. The FCC indicated
7 that the wholesale discount should not consider factors other than the removal of costs
8 avoidable by the ILECs. As a result, my earlier alternative suggestion that the resale
9 discount be adjusted would not be in accord with the FCC's recent order.

10

11 Q. WHAT IS THE BASIC COSTING METHODOLOGY APPLICABLE TO
12 CARRIER ARRANGEMENTS FOR NETWORK ELEMENTS,
13 INTERCONNECTION, TRANSPORT AND TERMINATION REQUIRED
14 BY THE FCC'S RULES?

15

16 A. The FCC's rule require that the basic components of exchange networks -- unbundled
17 network elements, interconnection, transport and termination -- be priced according to
18 economic costing principles, labeled by the FCC as "Total Element Long Run
19 Incremental Costs" ("TELRIC"). FCC Order, ¶ 678. TELRIC is the application of
20 the TSLRIC pricing principles to *network elements* as recommended in my prior
21 direct testimony.

22

23 Under the FCC's "TELRIC" methodology, the price of network elements should
24 collectively recover the forward-looking, long-run costs of providing network
25 elements, including the costs of the managerial and administrative functions necessary

1 to support a network-element company. These managerial and administrative costs
2 are directly caused by network elements in the aggregate, but cannot easily be
3 attributed to specific, individual, network elements. Because of the presence of these
4 “forward looking common costs” of providing network elements, the FCC's rules
5 permit the price of each *individual* network element to be increased above its
6 individual “TELRIC” to recover a portion of the *network-element-related* common
7 costs. This pricing rule is identical to the recommendation of my prior direct
8 testimony.

9

10 **Q. DID THE FCC RECOGNIZE THE IMPORTANCE OF EASILY**
11 **ACCOMMODATING CUSTOMER CHOICE?**

12

13 **A.** Yes. Two provisions of the FCC's rules, in particular, assure that consumer choice
14 can be easily accommodated. First, the Commission's rules require that operating
15 systems be nondiscriminatory in comparison to the use of these systems by the
16 incumbent LEC itself. As the FCC explained in its recent Order:

17

18 We thus conclude that an incumbent LEC must provide
19 nondiscriminatory access to their operations support systems
20 functions for pre-ordering, ordering, provisioning, maintenance and
21 repair, and billing available to the LEC itself.

22

23 FCC Order, ¶ 523.

24

25 Second, the rules include the requirement that, wherever the change in the customer's

1 local service provider is accomplished through a software event, (i.e., resale
2 arrangements or configurations using unbundled local switching), the change in a
3 customers' local service provider must occur in an interval no longer than the interval
4 in which an incumbent LEC transfers end-users between interexchange carriers. 47
5 C.F.R. § 51.319(c)(1)(ii).

6

7 These provisions of the FCC rules implement the environment that I described in my
8 direct testimony that will be necessary for consumers to broadly, and quickly, benefit
9 from local competition.

10

11 **Q. HOW DO THE FCC RULES TREAT THE PRICING APPLICABLE TO**
12 **THE TERMINATION OF LOCAL TRAFFIC?**

13

14 **A.** The FCC requires that transport and termination charges be cost-based.
15 Commissions may, however, implement bill-and-keep compensation if neither party
16 can demonstrate that traffic will be out-of-balance or that costs will be different.
17 Therefore, the rules permit the Commission to adopt the recommendation in my prior
18 direct testimony that bill-and-keep compensation be used until a cost-based charge is
19 established. Even then, however, the Commission may retain bill-and-keep for the
20 transport and termination of local traffic so long as costs and traffic flows are roughly
21 equivalent.

22

23 **Q. DO THE FCC'S RULES REQUIRE BELLSOUTH TO PROVISION**
24 **COMBINATIONS OF NETWORK ELEMENTS, INCLUDING THE**
25 **"PLATFORM" CONFIGURATION DESCRIBED IN YOUR DIRECT**

1 **TESTIMONY?**

2

3 **A.** Yes. The rules clearly recognize the rights of new entrants to order combinations of
4 network elements, including combinations of elements as they are presently
5 configured in the LEC network. Specifically, the FCC rules require that an
6 incumbent LEC:

7

8 (a) shall provide network elements in a manner that allows a requesting
9 carrier to combine such elements,

10

11 (b) shall not separate requested network elements that the LEC currently
12 combines,

13

14 (c) shall perform the functions to combine unbundled network elements
15 in any manner, even if those elements are not ordinarily combined in its network, if
16 the combination is technically feasible and will not impair other carriers from
17 obtaining access or interconnecting.

18

19 **47 C.F.R. § 51.315.**

20

21 These rules enable an entrant to combine local loops, local switching and transport
22 and termination to form a "virtual" exchange platform to offer local exchange (to end
23 users) and exchange access (to other carriers) service. This flexibility is essential if
24 consumers are to rapidly benefit from the introduction of local competition.

25

1 **The Interim Surcharge is Unnecessary and Would Raise Consumer Prices**

2

3 **Q. ARE THERE ELEMENTS OF THE FCC'S ORDER WITH WHICH YOU**
4 **DISAGREE?**

5

6 **A. Yes. The FCC has implemented a temporary interstate surcharge on the price of**
7 **unbundled local switching that substantially increases the cost of this network**
8 **elements. 47 C.F.R. § 51.515. By increasing the cost to carriers that would otherwise**
9 **use the unbundled local switching element to provide service, the FCC's interim**
10 **surcharge will decrease consumer choices or result in higher consumer prices.**

11

12 **Q. IS THE UNBUNDLED LOCAL SWITCHING ELEMENT IMPORTANT TO**
13 **LOCAL COMPETITION?**

14

15 **A. Yes. As I explained in my prior direct testimony, the local switching element is**
16 **central to widespread local competition. By obtaining local switching from the**
17 **incumbent, entrants should be able to quickly enter a market, providing local**
18 **exchange and exchange access services to customers broadly throughout the territory.**
19 **Unbundled local switching *does not* require a physical change in the loop serving the**
20 **customer -- the customer can continue to be served from the same switch, even**
21 **though the carrier providing the service has changed. Furthermore, unbundled local**
22 **switching provides entrants the ability to determine what vertical features are included**
23 **in their basic local offering, developing packages identical to, or different from, the**
24 **incumbent.**

25

1 The bottom line is this: unbundled local switching is the heart of ubiquitous local
2 competition. If the cost to entrants of this element is artificially increased, then the
3 entrant's ability to compete with the incumbent is compromised. The result is either
4 fewer choices for consumers, higher prices, or both.

5

6 **Q. WHAT IS THE NATURE OF THE FCC'S INTERIM SURCHARGE?**

7

8 A. The FCC adopted a surcharge system (47 C.F.R. § 51.515(b)) which increases the
9 price of the local switching element by a rate equal to the sum of two interstate access
10 rate elements: the carrier common line charge and 75% of the residual
11 interconnection charges. This surcharge is applied to any interstate minute of use that
12 is switched through the unbundled local switching element. This interim surcharge
13 has the effect of significantly increasing the price of unbundled local switching.

14

15 The FCC's interim surcharge will expire on the earliest of three dates:

16

17 1. June 30, 1997,

18

19 2. the later of the effective date of a final Commission decision in CC
20 Docket No. 96-45, Federal State Joint Board on Universal Service, or a final decision
21 in a proceeding to consider access charge reform, or

22

23 3. the date that BellSouth is authorized to provide interLATA service
24 pursuant to Section 271 of the Act.

25

1 In addition, the FCC has permitted states the *option* of implementing a similar interim
2 surcharge, subject to the requirement that any state surcharge expire before June 30,
3 1997, or the date upon which BellSouth is authorized to provide interLATA service,
4 whichever is earlier.

5

6 **Q. SHOULD THIS COMMISSION ADOPT AN INTERIM SURCHARGE**
7 **SYSTEM?**

8

9 A. No. The principal effect of the FCC's interim plan will be to delay carriers from
10 providing service using unbundled local switching and, by doing so, delay the benefits
11 of the ubiquitous competition that this network element could make possible.

12

13 As I indicated earlier, the unbundled local switching element is the element that
14 provides entrants the vehicle to offer service widely in the market. Furthermore, only
15 through the shared use and software control of the unbundled local switching element
16 can consumer choice can be implemented quickly, matching the ease and familiarity
17 of the process used to change long distance carriers.

18

19 By increasing the cost of the unbundled switching element -- however temporarily --
20 these benefits are delayed and/or the price to consumers is increased.

21

22 **Q. HAVE YOU QUANTIFIED THE IMPACT OF THE FCC'S INTERIM**
23 **SURCHARGE SYSTEM?**

24

25 A. Yes. Using data provided in 1996 BellSouth's interstate price cap filing, I estimate

1 that the cost increase caused by the FCC's interim plan is approximately \$3.82 per
2 subscriber line served by an unbundled switch. Thus, the interim surcharge would
3 raise the *cost* to other carriers to offer local exchange service -- and, ultimately, the
4 *price* for local exchange service paid by consumers -- by almost \$4.00 per line. An
5 increase in cost of this magnitude is significant.

6

7 The distorting influence of the surcharge is even more dramatic when compared to the
8 estimated cost of unbundled local switching. The FCC has concluded that default
9 value for unbundled local switching is in the range of 0.2 cents to \$0.4 cents per
10 minute, with the available evidence supporting a value at the lower end of the range.
11 The surcharge, when expressed per minute of use is 1.56 cents -- or nearly 400%
12 higher than the underlying cost!

13

14 New entrants require unbundled local switching to provide competitive alternatives to
15 BellSouth's local exchange service in those areas, and to those customers, where
16 alternative networks are not yet justified or in existence. If the Commission
17 arbitrarily increases the effective cost to new entrants beyond the economic cost of the
18 elements they use, the effect will be felt by consumers. The temporary surcharge
19 adopted by the FCC will seriously distort carrier choices and pricing; any state-
20 adopted plan will curtail these choices further. The Commission should not adopt,
21 even for an interim period, a surcharge on unbundled local switching.

22

23

SUMMARY

24

25 **Q. PLEASE SUMMARIZE YOUR SUPPLEMENTAL TESTIMONY.**

1

2 A. The FCC rules pass to this Commission the critical decisions leading to local
3 competition and the prices and choices that Florida consumers will experience in the
4 local exchange market. Overall, the rules adopted by the Commission are consistent
5 with my earlier testimony and I continue to endorse its recommendations and policy
6 rationale.

7

8 The FCC's rules, while generally committed to cost-based pricing, do provide for an
9 interim surcharge that I believe is ill-advised. Artificially increasing the cost to an
10 entrant for *any* unbundled network element -- much less an element as critical to local
11 competition as unbundled local switching -- will harm competition and, more
12 importantly, consumers.

13

14 The Commission should not adopt, for even the interim period authorized by the FCC,
15 a surcharge system. The best way to assure that consumers have low local exchange
16 prices is to assure competitors that they have cost-based access to the network
17 elements they will need to offer local exchange service. Cost-based network prices
18 will provide the best possible environment for the greatest amount of competition and
19 price protection.

20

21 Q. DOES THIS CONCLUDE YOUR SUPPLEMENTAL DIRECT
22 TESTIMONY?

23

24 A. Yes.

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REBUTTAL TESTIMONY OF
JOSEPH GILLAN
ON BEHALF OF AT&T COMMUNICATIONS OF
THE SOUTHERN STATES, INC.
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

Docket No. 960833-TP

Filed: August 30, 1996

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to BellSouth's characterization that the comprehensive arbitration now before the Commission is intended to:

- Confuse the Commission (Varner Direct, page 18),
- Delay BellSouth's interLATA entry (Varner Direct, page 12),
- Provide AT&T with a cost-advantage over its rivals (Varner Direct, page 18).

These themes, if not addressed, could distract the debate from the factual and practical issues that must be resolved before local competition becomes a reality.

Q. WHAT IS THE FUNDAMENTAL OBJECTIVE OF THIS ARBITRATION?

A. The fundamental objective of this arbitration *should be* the establishment of prices, terms, and conditions by which AT&T—and, importantly, any other entrant—will

1 use BellSouth's network to provide local exchange and exchange access services.
2 The purpose of my rebuttal is to keep the focus of this proceeding on this fundamental
3 question. As I indicated in my earlier direct testimony, the important dimension of
4 this arbitration is not that it involves AT&T (and now MCI), but rather that the
5 *comprehensive* nature of the arbitration will yield a result with an industry-wide
6 application.

7
8 The tone of BellSouth's testimony is that the relevant question is who is to "blame"
9 for the parties' not voluntarily settling these questions. The fact that there is a need
10 for Commission arbitration is not the *fault* of either side. BellSouth cannot be faulted
11 for having a network monopoly, or for wanting to narrow its use by others. Nor can
12 AT&T be faulted for needing comprehensive tools to provide local exchange services.

13
14 Importantly, the Telecommunications Act of 1996 and the FCC's implementing
15 regulations address this tension by fundamentally altering the relationship between
16 BellSouth and other carriers. The new relationship is founded on the entry tools and
17 prices required under Sections 251 and 252 of the Act and the associated federal
18 rules. The task before the Commission is to translate this framework into a viable set
19 of arrangements that AT&T and other carriers may use to provide local exchange and
20 exchange access services, and thus offer Florida consumers a choice of local service
21 provider.

22

23

THE CONFUSION IS CLEARING

24

25 **Q. DO AT&T AND OTHER ENTRANTS STAND TO GAIN FROM CREATING**

1 **CONFUSION?**

2 A. No. Local entrants need complex regulatory actions to make network elements and
3 wholesale services available to them so that they may enter the local exchange market.

4 As such, entrants require an educated, informed regulator to resolve these
5 complicated questions. Confusion does not assist the entrant, it can only delay the
6 availability of the tools that an entrant needs to provide service.

7

8 In contrast, BellSouth has but a single regulatory objective: its interLATA entry.

9 Once granted, BellSouth need not worry about operational and pricing concerns
10 because BellSouth has competitive choices for the network components and services
11 that it will purchase in order to provide long distance service. Local entrants do not
12 have a "choice of incumbent monopolies" to negotiate with; these entrants have only
13 the requirements and pricing rules of the FCC and the Act -- and, most importantly,
14 *this* Commission's decisions -- to be able to obtain the elements and services they will
15 need to compete.

16

17 **Q. IS THIS DISPARITY REFLECTED IN THE POSITIONS OF THE**
18 **PARTIES?**

19 A. Yes. The disparity between local and long distance entry barriers explains one of the
20 core disagreements between BellSouth and AT&T. BellSouth's principal motivation
21 is the promise of interLATA relief achievable after certain conditions are satisfied.

22 Significantly, BellSouth's objective is a binary result: they either obtain, or fail to
23 obtain, interLATA authority. Although interLATA authority is an extremely
24 valuable goal for BellSouth, it is a yes/no proposition. Whatever threshold is
25 established, BellSouth's incentive is to do no more than is absolutely required.

1

2 Local entrants, in contrast, do not face a binary problem. A *complete* menu of entry
3 tools is necessary to provide local services across the full range of market and
4 geographic conditions. BellSouth continues to characterize this proceeding as being
5 between AT&T and itself. In a very narrow sense, it is partially correct: the *direct*
6 participants in these proceedings are AT&T and now MCI. But the results of this
7 proceeding will define for an entire industry the terms under which they may provide
8 local exchange services in competition with BellSouth. And, while the Act can *define*
9 the basic tools of entry, it cannot implement them or establish their price.

10

11 A comprehensive arbitration necessarily raises a far longer listing of questions than a
12 more narrow application. But for local competition to proceed broadly throughout
13 Florida, a comprehensive set of tools must be provided. The Act recognized that
14 comprehensive tools were needed, and it provided entrants a clear entitlement to each
15 of the possible entry options so that competition could develop.

16

17 **Q. DO THE FCC'S IMPLEMENTING REGULATIONS HELP ELIMINATE**
18 **SOME OF THE ISSUES RAISED BY THE BELL SOUTH TESTIMONY?**

19 **A.** Yes. In many areas the FCC's rules provide implementing guidance to resolve some
20 of the issues raised in BellSouth's testimony. By removing the alleged "confusion"
21 regarding the requirements of the Act, the scope of the issues before the Commission
22 is narrowed. But the FCC's rules in no way diminish the importance of the
23 Commission's decisions here. While the FCC's rules provide guidance as to the
24 requirements of the Act, the Florida Commission is provided the latitude -- and here
25 rests the responsibility -- to resolve the issues most central to whether Florida

1 consumers will have a choice of local provider, when, and at what price.

2

3 **Q. DO YOU HAVE EXAMPLES WHERE THE FCC'S IMPLEMENTING**
4 **RULES NARROW THE ISSUES HERE?**

5 A. Yes. One issue that arises in several contexts is how to provide access to operator
6 and directory services. This is an important example because of its implications for
7 consumers. These services are typically used by consumers when they need
8 assistance: assistance finding a number, correctly dialing a call, or establishing some
9 form of alternative billing. Obviously, services intended to provide assistance must
10 be simple and easy to use in order for consumers to derive the intended benefit.

11

12 AT&T has requested the ability to provide its own operator and directory services,
13 both when it is using BellSouth's unbundled local switching element to provide
14 service and when it is reselling BellSouth's local exchange service. Although these
15 are separate and distinct questions, the technical solution to *implement* the requested
16 relief is the same: BellSouth's switches (where feasible) must provide an entrant the
17 ability to "customize" the routing of operator and directory traffic. That is, as
18 customers dial the familiar "0" and "411" dialing patterns, the calls must route to the
19 correct provider of operator and directory services.

20

21 **Q. HOW DO THE FCC'S RULES ADDRESS THE ROUTING OF OPERATOR**
22 **AND DIRECTORY SERVICES?**

23 A. The FCC's rules are structured to facilitate competition and preserve for consumers
24 the familiarity of the existing operator and directory assistance dialing patterns. The
25 FCC's orders require that BellSouth's unbundled local switch provide (where

1 technically feasible) for the routing of operator and directory traffic to another
2 provider (see paragraph 418 of the First Report and Order, Docket 96-98), and also
3 require non-discriminatory dialing parity to these important services (see Second
4 Report and Order, CC Docket 96-98). These policies enable entrants to offer better
5 (or less expensive) operator and directory services without causing consumers to lose
6 the benefits of a familiar dialing pattern.

7

8 **Q. HOW DOES BELL SOUTH PROPOSE TO PROVIDE CONSUMERS WITH**
9 **THE ABILITY TO REACH OPERATOR AND DIRECTORY SERVICES?**

10 A. To quote Yogi Berra, the BellSouth solution is “deja vu all over again.” With a
11 suggestion reminiscent (if not repetitive) of the equal access debates which preceded
12 the Bell System divestiture, BellSouth suggests that entrants use a different dialing
13 pattern for their operator and directory services (Scheye Direct Testimony, page 27):

14

15 BellSouth believes our customers are more adept than AT&T
16 implies. . . . Given the number of carriers and calling arrangements
17 provided, it is doubtful that customers would be particularly
18 confused by dialing “00” to reach an operator or a different seven
19 digit number to reach a repair center. *The issue is even further*
20 *simplified by the propensity of inexpensive handsets with speed*
21 *dialing capabilities which can be programmed with “1” for*
22 *operator, “2” for telephone repair, and “3” for directory*
23 *assistance.* (Italics added.)

24

25 At least BellSouth didn’t suggest “4” for the Commission’s Consumer Complaint

1 Division. Consider the irony of BellSouth's proposed solution: a customer seeking a
2 phone number must first consult the directory to obtain the number for directory
3 assistance; a consumer needing help placing a call must first obtain help reaching an
4 operator. The goal here is a better, less expensive, more responsive, local exchange
5 market for consumers, not customer confusion and a repeat of the "dialing pattern"
6 nightmares of the 70's and 80's.

7

8 **Q. ARE THERE OTHER EXAMPLES OF A BELLSOUTH STATUTORY**
9 **INTERPRETATION THAT THE FCC'S RULES CLARIFY?**

10 **A.** Yes. BellSouth takes the position that entrants may not use combinations of network
11 elements to provide service. Remarkably, BellSouth takes the position that (Scheye
12 Direct Testimony, page 57):

13

14 Nowhere in the Act does it anticipate the recreation of an existing
15 service by the simple reassembling of the LEC's unbundled elements.

16

17 Perhaps Mr. Scheye overlooked the final sentence in Section 251(c)(3) which clearly
18 establishes the entrant's right to combine elements to provide any service they desire,
19 including, if they choose, a service identical to BellSouth's:

20

21 An incumbent local exchange carrier shall provide such unbundled
22 network elements in a manner that allows requesting carriers to
23 combine such elements in order to provide such telecommunications
24 services.

25

1 The FCC (who did not overlook this provision of the Act) expressly permits carriers
2 to combine elements to provide any service (paragraph 292, First Order and Report,
3 Docket 96-98):

4

5 We agree with the Illinois Commission, the Texas Public Utility
6 Counsel, and others that this language [Section 251(c)(3)] bars
7 incumbent LECs from imposing limitations, restrictions, or
8 requirements on requests for, or the sale or use of, unbundled
9 elements that would impair the ability of requesting carriers to offer
10 telecommunications services in the manner they intend.

11

12 Indeed, the FCC specifically rejected BellSouth's view that unbundled elements may
13 only be purchased by so-called facilities-based carriers (paragraph 328, First Order
14 and Report, Docket 96-98):

15

16 We [the FCC] conclude, therefore, that Congress did not intend
17 section 251(c)(3) to be read to contain any requirement that carriers
18 must own or control some of their own local exchange facilities
19 before they can purchase and use unbundled elements

20

21 The FCC reached these conclusions for good reason: The Act intended to provide
22 entrants with a broad ability to offer consumers a choice in provider. There are no
23 litmus tests or hoops that entrants must satisfy in order to obtain network elements in
24 any combination they desire to offer consumers new (or even the same) services.

25

1 Q. DO THE FCC'S RULES CLARIFY THE ACT IN OTHER WAYS?

2 A. Yes. The FCC's rules also narrow the scope of AT&T's request. AT&T had
3 requested that the wholesale discount applicable to resold local exchange services be
4 increased to adjust for inferior operating systems and to provide an additional impetus
5 for local entry and competition. The FCC's Order, however, precludes the
6 Commission from directly considering these factors (see paragraph 914, First Report
7 and Order, Docket 96-98). Thus, the FCC's rules reduce the issues on both sides of
8 the arbitration, eliminating positions of both BellSouth and AT&T.

9

10 **LOCAL COMPETITION REQUIRES A COMPREHENSIVE ARBITRATION**

11

12 Q. ARE BELLSOUTH'S AGREEMENTS TO DATE SUFFICIENT FOR
13 LOCAL COMPETITION?

14 A. No. BellSouth witness Scheye places great emphasis on its 15 agreements (Scheye
15 Direct Testimony, page 5), implying that these agreements are sufficient for local
16 competition and alleging that AT&T's comprehensive request is intended to delay
17 BellSouth's interLATA entry.

18

19 First, the facts do not support the claim that these "voluntary" agreements have laid
20 the foundation for broad-based local competition. Despite BellSouth's claim that
21 these agreements have allowed "*local competition to move forward in this state*"
22 (Scheye Direct Testimony, page 4), local competition has not moved forward very
23 far. The following table summarizes the quantities of unbundled loops, ports and
24 interconnection trunks provided to entrants in Florida:

25

1 **Table 1: The Status of Local Competition**
 2 **Network Components Obtained by Competitors**

3	4 <u>Network Unit</u>	5 <u>BellSouth Quantity</u>	6 <u>Unbundled Quantity</u>
7	Loops	5,484,755	1
8	Switch Ports	7,667,002	0
9	Interconnection Trunks	5,338,776	1,000

10 Data Sources: Loops are from Items 7, 8 and 9, FIXCA's First Set, 960786-TL.

11 Ports are from Items 12 and 13, FIXCA's First Set, 960786-TL.

12 Interconnection Trunks from BellSouth Witness Calhoun, page 7.

13 * Statistic may be regionwide, not Florida-specific.

14 BellSouth interconnection trunk quantity uses interoffice carrier
 15 links as a proxy. ARMIS 43-07, 1994.

16 As the above table shows, any "claim" that the voluntary agreements are sufficient to
 17 enable local competition is not supported by the quantitative evidence. The Act's
 18 success cannot be measured by how many voluntary agreements exist; it can only be
 19 measured by the prices and choices that Florida consumers experience as a result.
 20 AT&T (and the entire industry) is entitled under the Act to a full range of options at
 21 cost-based rates. This policy was adopted so that consumers could have the greatest
 22 range of choices at the lowest possible price. The fact that some carriers have
 23 voluntarily agreed to less (for whatever reason) does not diminish the right of other
 24 entrants -- or the intended beneficiary of that right, the ultimate consumer -- to the full
 25 implementation of the tools Congress created.

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**Q. DOES BELLSOUTH'S TESTIMONY ILLUSTRATE WHY A
"VOLUNTARY" AGREEMENT IS UNLIKELY?**

A. Yes. BellSouth's own explanation of its position illustrates why this Commission must implement Sections 251 and 252 and not wait for "voluntary agreements" to establish these conditions. Consider the interaction of the following statements by BellSouth's two principal witnesses (emphasis added):

Mr. Scheye states:

BellSouth has approached the AT&T negotiations with the same sincere desire to negotiate a reasonable, *mutually beneficial* agreement

Direct Testimony, Page 7.

Mr. Varner provides more detail as to what BellSouth considers "mutually beneficial":

If the resale discount and the pricing of unbundled network elements is done correctly, there would be *no negative financial impact* to BellSouth.

Direct Testimony, Page 20.

In other words, BellSouth will voluntarily agree to the pricing of an entry option so long as it is indifferent between retaining a customer or losing it to a rival. Sections 251 and 252 are not intended to leave BellSouth indifferent. They are intended to provide rivals with the same cost structure for the use of BellSouth's network as

1 BellSouth's own retail services. In this way, competition will drive all other costs
2 (and, where possible, facilities-costs as well) to their lowest possible level.

3

4 **Q. WILL AT&T'S COMPREHENSIVE ARBITRATION REQUEST DELAY**
5 **BELLSOUTH'S INTERLATA AUTHORITY?**

6 A. No, this characterization lacks any logical foundation. BellSouth's interLATA entry
7 is dependent upon BellSouth's satisfying the requirements of Section 271. AT&T's
8 comprehensive arbitration request (when fully implemented) will promote the entry
9 and competition contemplated by the Act. Although BellSouth's interLATA entry
10 raises issues not addressed in this arbitration (and is the subject of a separate
11 proceeding), if anything, a comprehensive proceeding of this nature should assist
12 BellSouth's compliance with Section 271, albeit under conditions where others will be
13 able to compete effectively. I see no rational linkage between comprehensively
14 enabling local competition and delaying BellSouth's ability to demonstrate its
15 compliance with the requirements of Section 271.

16

17 **THIS ARBITRATION WILL GIVE NO**
18 **ARTIFICIAL ADVANTAGE TO AT&T**

19

20 **Q. CAN THIS ARBITRATION PROVIDE AT&T A PREFERENTIAL RATE**
21 **FOR NETWORK ELEMENTS AND WHOLESALE SERVICES?**

22 A. No. BellSouth's allegation that this arbitration will singularly benefit AT&T is false.
23 This arbitration will result in a comprehensive set of tools to support local entry that
24 satisfies the cost-standards of the Act and the FCC's implementing rules. The Act
25 guarantees -- and the FCC's rules (47 C.F.R. §51.809) are explicit on this point --

1 that *any entrant* may avail itself of *any component* of an interconnection agreement.

2

3 AT&T cannot obtain a cost-structure advantage over its rivals through this
4 arbitration, because each of its elements would be available to all other competitors.
5 The only price differential that would be justified between AT&T and other entrants
6 would have to be a difference based in cost.

7

8 In fact, this Commission should strive to prevent any agreement which would favor a
9 particular competitor over another. Competition is the process by which the cost-
10 based pricing of network elements flow through to consumers. Except where a
11 particular arrangement has unique cost characteristics, the Commission should
12 diligently evaluate agreements to prevent any unjustified price differentials.

13

14 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

15 **A. Yes.**

1 Q (By Ms. Dunson) Mr. Gillan, did you
2 prepare a summary of those testimonies?

3 A Yes, I did.

4 Q Would you please give it for the record?

5 MR. LACKEY: Madam Chairman, before he
6 starts the summary, I have a request to make. I
7 realize it may sound a little funny, but could we get
8 Mr. Gillan to move over a couple of chairs?

9 CHAIRMAN CLARK: Yes.

10 MR. LACKEY: I'd like to be able to watch
11 him when he's doing this, and I can't see him where he
12 is.

13 CHAIRMAN CLARK: I'm sure he's not implying
14 your shift in any way, Mr. Gillan.

15 MR. LACKEY: No. I wasn't. I just can't
16 see him.

17 CHAIRMAN CLARK: Do we need to have the
18 easel moved? I don't know if Mr. Lackey can see it or
19 not.

20 MR. LACKEY: I'm fine with the easel.

21 CHAIRMAN CLARK: Thank you.

22 WITNESS GILLAN: Good afternoon. It is said
23 one of the benefits of a near-death experience is it
24 forces you to think back on what's important in your
25 life. I'm thinking that the imposition of a

1 five-minute limit on summaries has the same effect in
2 terms of deciding what's important in your testimony.

3 As I looked over my testimony and tried to
4 decide what really can I tell you in five minutes that
5 I wanted you to absolutely and unequivocally hear, it
6 distilled down to two fundamental points.

7 The first point has to do with conveying to
8 you how fundamentally different the world will be
9 under the Telecommunications Act of 1996 when fully
10 implemented, and how dramatically important it is that
11 the Commission fully implement that Act, which really
12 ties to the second main point.

13 And that main point is that under this new
14 environment, the principal means available to the
15 Commission to influence the choices that Florida
16 consumers have and the prices they will pay for local
17 exchange, long distance, and every other
18 telecommunications service will be through its
19 discharge of the responsibilities in establishing the
20 carrier-to-carrier relationships that will decide what
21 types of services and prices competitors can offer.

22 The seeds of the Telecommunications Act of
23 '96, I believe, can be traced back to the AT&T
24 divestiture and an extension of some of the theories
25 that underlie that agreement.

1 Long distance competition was made possible
2 in this country because the existing local exchange
3 network was made available to multiple carriers, but
4 only in one of its roles, and that role was to
5 originate and terminate long distance service. By
6 making that network available to multiple companies to
7 do one of the things it's capable of, we are able to
8 have, and did have, long distance competition.

9 Fundamentally the Telecommunications Act of
10 1996 takes that same premise and expands it and
11 changes it somewhat to say that we will make available
12 to multiple companies the exchange network in all of
13 its roles. Carriers will be able to buy and use that
14 network to provide not just long distance services,
15 but local services, exchange access services, any
16 telecommunications service. And in addition, we will
17 make sure that interconnection opportunities are
18 provided so that as additional networks are deployed,
19 companies can interconnect their networks with the
20 incumbent network.

21 The key principle here, though, I think, is
22 to understand that the Act is founded on the idea that
23 that network will be made available to all competitors
24 through really a comprehensive mosaic of different
25 tools so that competition can occur rapidly and it can

1 occur broadly.

2 If all Congress was interested in was seeing
3 that a few selected customers in downtown business --
4 in downtown business districts saw local competition,
5 all Congress needed to address was giving carriers the
6 opportunity to interconnect their networks and to
7 complete and terminate traffic; if that was all that
8 was necessary, then networks would be deployed to
9 those few locations where concentrations of traffic
10 are sufficient to justify those kinds of investment.

11 But in my mind the Act did not end there.
12 It did not look at just a single entry strategy. It
13 went beyond that to say that multiple entry strategies
14 will be made available so that competition could move
15 beyond these business districts, and as rapidly and
16 broadly as possible get to small residential
17 customers -- small businesses and residential
18 customers. Fundamentally that's what you're going to
19 decide here in this proceeding.

20 What are the terms and conditions of each
21 one of these entry strategies so that competition can
22 expand as rapidly and broadly and forward as possible?
23 The two other entry strategies are resale and the use
24 of network elements.

25 Resale is relatively straightforward. It

1 involves obtaining from BellSouth their finished
2 retail services and paying them a wholesale rate
3 reoffering those services to the public. That
4 strategy can easily be seen to permit broad entry,
5 albeit one that does not have the same ability for
6 innovation and price competition as I think the public
7 expects and would desire.

8 Secondly, Congress envisioned a system of
9 network elements, effectively, saying to the LEC, you
10 must make available your network as a set of basic
11 ingredients. These basic ingredients can be used by
12 others to craft their own local exchange and exchange
13 access services. That, in effect, is the core of one
14 of the issues in this arbitration.

15 AT&T and others have requested that every
16 basic ingredient be made available, because if any
17 ingredient is withheld from them, there will either be
18 services they cannot offer or customers they cannot
19 serve, and that will be the consequence of not fully
20 implementing the Act.

21 Overarching the entire spectrum of these is
22 the need for this Commission to oversee the
23 introduction of new operating systems. I will take
24 you back to divestiture, an event that I unfortunately
25 got to live through once.

1 Divestiture wasn't just the separation of
2 the Bell system from AT&T, it was the implementation
3 of all the new systems that were going to be necessary
4 so that multiple carriers could use the local network
5 and customers could easily choose their long distance
6 provider.

7 If local competition is to be a success --
8 and by "success," I define that as a broad number of
9 customers throughout the entire BellSouth region very
10 quickly having the opportunity to choose another
11 carrier. Those same types of changes are going to be
12 necessary. This is as fundamental a restructuring as
13 divestiture was. The network is going to have to be
14 made to accommodate multiple providers using it to
15 provide services, and it's going to have to be
16 supported by operating systems that make it as easy
17 for other carriers, carriers other than BellSouth, to
18 offer services to customers as it is for BellSouth to
19 provide this local exchange in exchange access
20 services.

21 In short, and in conclusion within my five
22 minutes, the key element of my testimony is to
23 emphasize to you that what makes this arbitration
24 unique is you are going to be fully implementing a
25 statute that was intended to lead to comprehensive

1 choice, comprehensive choice for residential customers
2 and business customers, as rapidly as possible. Thank
3 you.

4 MS. DUNSON: The witness is available for
5 cross examination.

6 CHAIRMAN CLARK: Mr. Melson. Mr. Horton.
7 Mr. Carver.

8 MR. CARVER: Yes, Madam Chairman, we have
9 some questions.

10 CROSS EXAMINATION

11 BY MR. CARVER:

12 Q Good afternoon, Mr. Gillan.

13 A Good afternoon.

14 Q My name is Phil Carver, and I represent
15 BellSouth. To begin with, I'd like to ask you a few
16 general questions about the position that you
17 espoused.

18 Is it fair to say, generally, that you are
19 offering your testimony today from the perspective of
20 what's good for competition and for consumers, not
21 necessarily what's good for AT&T or for BellSouth?

22 A That is fair.

23 Q And it's your view that the new Federal Act
24 is supposed to occasion the transition in the
25 structure of the telecommunications industry where

1 lines between carriers and services and markets
2 disappear to the maximum extent possible; is that
3 correct?

4 A When the Act is fully implemented and if it
5 is successful, then that would be, I believe, the
6 competitive endpoint, yes.

7 Q But you believe that that is the purpose?

8 A That is the envisioned endpoint, yes.

9 Q And the predicate to the implementation of
10 this intent would be that there would be an emergence
11 of local competition, not just on a limited scale, but
12 on a broad scale, and it will be available to all
13 residential subscribers and to all business
14 subscribers; is that correct?

15 A Yes.

16 Q Now, at least one of the benefits the
17 consumers should realize from this broad scale change
18 is that both residential and business customers should
19 ultimately have a reduction in the prices that they
20 pay. Wouldn't you agree with that?

21 A That would be one benefit. They will either
22 get the same service at lower prices or newer services
23 at a different price.

24 Q Now, would you agree with me that the
25 intraLATA toll market is currently an effectively

1 competitive market that has substantial choices for
2 consumers?

3 A Yes.

4 Q And would you agree with me also that there
5 are now at least four national networks that are
6 available for intraLATA and interstate competition?

7 A Yes.

8 Q These are, I believe, AT&T, MCI, Sprint and
9 WilTel; is that correct?

10 A Yes, where WilTel is now a subsidiary of
11 LDDS WorldCom.

12 Q So to put it a little bit differently, you'd
13 agree that currently there is facilities-based
14 competition nationally?

15 A I sorry, I missed the last part of your
16 question.

17 Q I was just trying to recast it a little bit.
18 At this point you would agree with me, wouldn't you,
19 that there is facilities-based competition nationally?

20 A In the intraLATA market, yeah, generally. I
21 mean, there are some areas that don't quite have four
22 networks, and there are other areas that have more
23 than four networks.

24 Q But all four of those networks are national
25 in scope?

1 A All four of those networks have the
2 capability of providing national service. In the
3 interexchange market, frequently carriers have traffic
4 exchange agreements or capacity agreements where even
5 though -- where there aren't four networks, national
6 service is available. But, yes.

7 Q Okay. In your testimony, I believe it's on
8 Page 27, and you can refer to it if you want, but to
9 move things along, I'm just going to go ahead and give
10 you the quote and ask you if this is what the
11 testimony says. I believe you say NYNEX recently
12 indicated to Wall Street analysts that it anticipated
13 an 80% discount on the long distance services it buys
14 at wholesale; is that correct?

15 A Yes, that's what they indicated.

16 Q And I believe you also said on that same
17 page, a little bit further down, and I'm quoting
18 again, "Reseller spreads in long distance are already
19 huge," and in parentheses, "50%, given the existence
20 of four fiercely competitive long distance networks";
21 is that correct?

22 A Yes.

23 Q Now, what's leading to those competitive
24 prices is the existence of facilities at NYNEX, and
25 these other companies can choose to buy; isn't that

1 true?

2 A Yes.

3 Q Now, back in the early '80s, let's say
4 around 1982 when MCI first began to go into the long
5 distance business and compete with AT&T, did it have
6 available to it then four alternative facilities-based
7 carriers from whom it could buy services?

8 A No.

9 Q So at least some instances, MCI was required
10 to buy AT&T services and to resell them, correct?

11 A Their services or facilities from them.

12 Q Now, would you agree that if competitive
13 long distance networks had not been built and MCI and
14 others were still reselling AT&T's network, that
15 consumers of telecommunication services would be worse
16 off now than they are?

17 A Yeah, I think that's a fair assumption. I
18 would think what we've found is that as we began the
19 nation's experiment with telecommunications
20 competition and tried to find
21 where-is-it-that-it's-in-a-monopoly and
22 where-is-not-a-natural-monopoly, the theories
23 underlying divestiture were proven to be correct.
24 Long distance transmission is not a natural monopoly.
25 If you try to extend this principle,

1 however, just blindly into the local market, all the
2 way to the premise of the subscriber or anywhere into
3 it, I think you'll be making a mistake. You cannot
4 simply draw the parallel that over the past 10 years
5 where we got four long distance networks and enormous
6 competitive benefits flowed from that, that all you
7 have to do is open up the local market, and we will
8 get four local telephone networks, and benefits will
9 flow from that. It's a substantially different
10 proposition, a much more difficult proposition to
11 expect that the local market will become such a
12 commodity for transmission and switching that the long
13 distance network did. Those are fundamentally
14 different networks.

15 Q But to go back to my question, that being
16 your prediction for the local market aside, the fact
17 that facilities-based competition developed in the
18 intraLATA market and in the interstate market has
19 benefitted consumers. You would agree with that,
20 would you not?

21 A Absolutely.

22 Q Thank you. Now, going back again to when
23 this competition was in an earlier stage between AT&T,
24 MCI, the other interstate carriers, when MCI went to
25 buy facilities from AT&T, did they pay AT&T the

1 forward-looking total element or the total service
2 long run incremental costs for the facilities?

3 A No.

4 Q And at that point, didn't MCI buy at least
5 some of the services from AT&T at tariffed rates?

6 A Yes, yes. They bought some at tariffed
7 rates; they bought some at negotiated rates; they
8 bought some from other network providers to the extent
9 that there are private networks.

10 Q Now, it's simple -- I sorry.

11 A Well, I was just going to jump ahead and
12 point out that the fact that we didn't have
13 TELRIC-based prices there goes more to explaining why
14 it took so long to get long distance competition. And
15 also, really required that AT&T ultimately had to
16 divest the exchange network that we are here to talk
17 about today for that competition to succeed at all?
18 Really, just goes to illustrate why it is so important
19 for this facility to be made available.

20 Q Mr. Gillan, I didn't want to interrupt you,
21 but, Madam Chairman, I would like to ask for an
22 instruction to the witness that he answer my
23 questions.

24 CHAIRMAN CLARK: Mr. Gillan, if you would,
25 answer the questions. And I'm sure, to the extent

1 there needs to be a further explanation, that will be
2 explored on redirect. Go ahead, Mr. Carver.

3 MR. CARVER: Thank you, Madam Chairman.

4 Q (By Mr. Carver) Now, Mr. Gillan, at some
5 point MCI decided that it was preferable to build its
6 own network rather than to purchase facilities or
7 resold services from AT&T; isn't that correct?

8 A That's how they started, building their own
9 network.

10 Q And that's the way that they offer services
11 exclusively now, correct?

12 A No. No, absolutely not. There's no
13 provider of competitive telecommunication services in
14 the country, to my knowledge, that provides services
15 exclusively over their own facilities.

16 Q Would you agree with me that MCI provides
17 services over its own facilities whenever it can?

18 A Of course.

19 Q And you would agree with me also that any
20 competitor in the intraLATA market would prefer to
21 offer services over its own facilities when it can?

22 A When it can. Except to the extent that a
23 very large portion of this market is served by people
24 who don't own any facilities. And it's not that they
25 would prefer to own facilities but have chosen not to.

1 The fact of the matter is that you can obtain long
2 distance capacity at competitive commodity rates and
3 be in the long distance business.

4 Q Now, throughout this entire time span, going
5 back to the early '80s and up to now, during this
6 15-year time span, if MCI could have purchased AT&T's
7 network on an unbundled basis at prices that are lower
8 than what it cost to build its own, wouldn't you
9 assume that MCI, they would have built its own
10 network?

11 A Absolutely not. I mean, the very fact of
12 the matter that we ended up with four networks
13 demonstrates to me that the long distance network was
14 not a natural monopoly and, therefore, there was no
15 inherent benefit from buying capacity from AT&T at its
16 TELRIC cost because you could achieve those with your
17 own business. I mean, that's why we have four
18 networks. We proved the proposition that it wasn't a
19 natural monopoly.

20 Q Well, I think you ignored part of the
21 predicate of my question, Mr. Gillan, so let me go
22 back. I didn't ask you what happened. I asked you if
23 MCI could purchase portions of AT&T's network for less
24 than it would cost to build its own; then it simply
25 would not have built its own. Wouldn't you agree with

1 that?

2 A So, you're right. I didn't hear the part of
3 the question where you asked me to assume that AT&T's
4 costs were lower than MCI's, and you're right. If one
5 were to assume, which history has shown to be a false
6 assumption, that AT&T's costs were lower than MCI's,
7 MCI would have bought capacity from AT&T instead of
8 building their own which, of course, is the correct
9 outcome for society. You wouldn't want to encourage
10 MCI to build a network just to have a network, given
11 the fact that AT&T's costs were lower.

12 Q So, in other words, you would want MCI to
13 build a network if it could do so more efficiently or
14 if it could build a cheaper network than the AT&T
15 network, correct?

16 A Or of AT&T's network, which is to say if
17 AT&T's network is not a natural monopoly which events
18 have all shown that to be the case.

19 Q So that is a yes?

20 A That was an emphatic yes.

21 Q Okay. Let me read you a statement about the
22 Federal Act and ask you if you agree with this
23 statement. "Where people can implement facilities at
24 a lower cost than Southern Bell, they are encouraged
25 to do so. Where people cannot do that, they are

1 encouraged to obtain the facilities from BellSouth,
2 but then to turnaround and make that cost structure
3 available in the marketplace so the consumers get the
4 lowest possible cost with the greatest choice with the
5 greatest quality."

6 A Would you agree with that statement?

7 A It was a long statement, but I agree with it
8 to the extent that I understood all the causes.

9 Q That, by the way, Mr. Gillan, was your
10 statement in North Carolina. I just wanted to see if
11 you had changed your position since then?

12 A No. I just wish I was more succinct.

13 (Laughter)

14 Q I can empathize with that. So, basically,
15 if BellSouth's costs are lower than a competitor's
16 costs, you believe the competitor should not build its
17 own facilities?

18 A It's not the economic thing to do, as
19 opposed to having the competitor use those facilities
20 in competition --

21 Q And my question -- I'm sorry, I didn't
22 really -- let me clarify my question. From an
23 economic standpoint, you would agree that if
24 BellSouth's costs are lower, then the competitor
25 should use BellSouth's network as opposed to building

1 its own?

2 A Yes.

3 Q Thank you. Now, is it your position that
4 regulatory policy should not favor either resale entry
5 or facilities-based entry?

6 A Yes.

7 Q Okay. Now, would you agree that if
8 unbundled network elements are priced below the
9 relevant costs to provide those elements, then the
10 incentive for facilities-based entry is going to be
11 lessened?

12 A Yes.

13 Q Would you also agree that if the wholesale
14 discount on a particular service is so large that the
15 price that the retailer has to pay for the wholesale
16 service is less than its cost to BellSouth, then
17 that's also going to dampen facilities-based entry; is
18 it not?

19 A Okay. I'm going to need you to say that one
20 slower because it appeared to have a number of
21 underlying assumptions that I need to have clarified.

22 Q Okay. You have a service, and the service
23 has a particular cost. Now, if BellSouth is required
24 to resell that service below its cost to competitors
25 that are going to offer it on a retail basis, isn't

1 that going to discourage those competitors from
2 building their own networks?

3 A Without any elaboration on additional facts,
4 the answer to that would be yes. The practical
5 application in this industry is a lot more complicated
6 owing to the fact that when a carrier resells one of
7 Southern Bell services, say the local exchange
8 service, Southern Bell continues to provide the
9 exchange access to that customer. And so, the
10 relative incentives of the reseller and BellSouth
11 become far more complicated in the real world than
12 your question might have suggested. But strictly
13 stated, the answer to your question is yes, so long as
14 we ignore all the real world complications.

15 Q So what you are saying is that a competitor
16 might decide to build its own facilities or to buy
17 unbundled elements to avoid paying access charges?

18 A No, I don't think I said that at all. I
19 said that you might make a decision to build -- or you
20 would make a decision to build a facility or use
21 unbundled network elements. Judging from those
22 decisions, all the revenues that would be available to
23 you from those decisions compare to all the costs that
24 you would incur. That's completely different than the
25 connotation that you tried to give it.

1 Q What am I missing here? You are saying that
2 the service is available to the competitor for below
3 BellSouth's cost, but the competitor might want to go
4 build its network and offer facilities that way,
5 despite the fact that it can obtain the service from
6 BellSouth for less than it cost BellSouth.

7 Now, I heard you say that one of the reasons
8 it might do that is to avoid paying access charges.
9 And I think I also heard you say that there might be
10 some other revenues streams that the competitor would
11 want, and he would build his facilities for that
12 reason. Did I miss anything? Are there any other
13 reasons?

14 A Well, to move this along, I'll accept that
15 with the following caveat. The way you describe avoid
16 paying access charges, it gives it a perjorative
17 coloration which is absolutely inappropriate here.

18 Obviously, you don't pay access charges to
19 reach your own customers. So, yes, it is true that
20 when you build a facility, you use network elements to
21 serve a customer, you no longer pay to reach your own
22 customers and, therefore, that is part of the
23 financial equation you use in making those decisions.
24 I just want to make sure that the Commission doesn't
25 interpret this avoiding-access-charges in some

1 negative way.

2 Q But the bottom line of what you are saying
3 is that if a competitor buys unbundled elements, it
4 doesn't have to pay access charges. We can agree on
5 that, can't we?

6 A Not to reach its own customers, that is
7 right. Once I sign up customers and I have paid for
8 the facilities to serve my customers and they are my
9 customers, then the carrier who is providing service
10 to this customer, who is this customer's local
11 telephone company, does not continue to pay other
12 charges to BellSouth to reach their own customers.

13 Q And when you talk about them reaching their
14 own customers, you are talking about the customers
15 that they are serving at least in part through the
16 network elements that have been unbundled that are
17 BellSouth's, correct?

18 A They could be serving them that way. They
19 could be serving them on their own facilities. How
20 they serve them isn't anywhere near as material as the
21 fact that they are now that customer's local telephone
22 company. Local telephone companies get some money
23 from the customer directly, and they get some money
24 from other carriers trying to reach that customer.

25 When a carrier becomes a local telephone

1 company in competition with BellSouth in the full
2 sense of that word, they have a subscriber base, those
3 are their customers. They do not pay access charges
4 to reach their own customers.

5 Q Okay. I think at the end of that you
6 finally answered my question which is that if a
7 competitor buys unbundled network elements from
8 BellSouth and puts them back together in the way that
9 you believe that they should be able to, they are not
10 going to pay access charges to BellSouth. Please, yes
11 or no.

12 A The answer is, yes, because they have fully
13 paid BellSouth for those facilities.

14 Q Thank you. Now, we were talking a little
15 bit earlier about revenue streams. Let's assume that
16 a particular customer doesn't make significant long
17 distance calls. In other words, basically just uses
18 local service. Do you think it's likely that AT&T or
19 any other competitor is going to build a network to
20 serve that customer?

21 A It's hard to say. It depends on where they
22 live. If they live in an apartment building where
23 there's a network extended to that apartment building
24 and it's only a question of cross connecting them in
25 the basement to provide them service, the answer is

1 probably yes. If they live out in some rural area or
2 beyond where a network is going and the network is
3 being developed to exclusively serve that customer,
4 the answer is probably no.

5 Q So basically then, the competitor would
6 either serve that customer or not, depending on
7 whether it could extend its network to serve the
8 customer and still make a profit given the fact that
9 they are only using local service. Is that accurate?

10 A If you were to make network design decisions
11 on the basis of individual customer consumption
12 patterns, yes. You know, as a practical matter is
13 that how people do this? No. I mean, they build
14 networks to premises; and sometimes those premises
15 have a good customer, and sometimes they have a bad
16 customer.

17 Q But if you knew they were going to be what
18 you define as a bad customer; that is customers that
19 just use local service, then they wouldn't build the
20 networks to reach those, to use your term, "bad
21 customers," would they?

22 A That's not the testimony I'm offering. I'm
23 trying to point out to the Commission that when you
24 make a network investment decision like that, it's a
25 long-term decision. You don't expect the same people

1 to live in the same buildings for all of their life
2 and for the entire life of your asset.

3 If I were to build a network into a
4 residential neighborhood --

5 CHAIRMAN CLARK: Mr. Gillan, you do need to
6 work on being succinct. I think you did answer the
7 question in that case, and we understand that it is a
8 long-term decision not based on the customer that is
9 now there. Do you still feel that you need to explain
10 it further?

11 WITNESS GILLAN: No, ma'am.

12 CHAIRMAN CLARK: Okay.

13 WITNESS GILLAN: But I might if he keeps
14 asking me the same question. (Laughter)

15 CHAIRMAN CLARK: I do notice a pattern, that
16 you explain it in several different ways. And I can
17 tell you that pretty much I get it on the first
18 explanation, so it will help move the hearing along.

19 MR. CARVER: Thank you.

20 Q (By Mr. Carver) Mr. Gillan, let me ask you
21 now -- let's move away from competitors' building
22 networks to competitors buying unbundled elements. If
23 the price of a loop is greater than the price of the
24 1-FR, then AT&T isn't going to want to buy the loop to
25 serve any customer who doesn't produce some sort of

1 revenue other than what's generated by the 1-FR,
2 correct?

3 A That is true.

4 Q How much is the -- I'm moving to a different
5 area now. How much is the resale discounts that AT&T
6 has proposed?

7 A It's in the 40% range.

8 Q Okay. Is AT&T advocating that BellSouth be
9 required to wholesale its services below its costs?

10 A I don't know if that's true or not because I
11 don't know what the relationship to the cost would be.
12 There would be no reason to not wholesale the service
13 below cost given the relationship to access -- given
14 the relationship between resale and access.

15 Q So then you think that if the discount that
16 AT&T is advocating is going to require a particular
17 BellSouth service being sold below cost, that
18 BellSouth should nevertheless be required to give you
19 that level of discount, correct?

20 A Yes, because it doesn't mean that BellSouth
21 would necessarily be losing money on that customer
22 because they retain revenue.

23 Q Because they'll make it up somewhere else,
24 right?

25 A No, because they retain revenues from that

1 customer.

2 Q Okay. Let's talk a little more about
3 discounts. Now, your concept of the effective
4 discount, as I understand it, is that there's a
5 nominal discount, which I think you've told us is
6 somewhere around 40%, and that it really should be
7 reduced to an effective discount based on the fact
8 that if the service is resold, BellSouth will continue
9 to have access revenue; is that correct?

10 A No.

11 Q I'm sorry, what am I getting wrong?

12 A I didn't say anything about reducing the
13 discount. The analysis just pointed out to the
14 Commission that if a customer leaves BellSouth and
15 goes to a -- the average customer, if you will, leaves
16 BellSouth and goes to someone who is reselling local
17 exchange service, BellSouth does not actually receive
18 40% less revenues because they do retain the access
19 revenues. Numerically, on average, if the retail
20 discount is 40%, the realized reduction in BellSouth's
21 revenues from that customer is only 24%.

22 Q So, just to cut to the chase here, what
23 you're really saying is it's not as bad as it looks
24 because BellSouth gets to keep some access revenue,
25 correct?

1 A That's one way of saying it.

2 Q Now, do you believe that most customers
3 prefer one-stop shopping? That is to retain all of
4 their telecommunications services from one provider if
5 they have the opportunity to do that?

6 A Yes.

7 Q Now, if you are right about that, wouldn't
8 the resold customers of AT&T also tend to move to AT&T
9 for their intraLATA toll service?

10 A Yes.

11 Q Okay. Now, would you agree with me that the
12 average revenue per minute is greater for intraLATA
13 toll service than for the corresponding intraLATA
14 access?

15 A With the exception of expand -- ECS, yes.
16 In which case the relationship is reversed.

17 Q So if you are figuring your effective
18 discount, shouldn't you factor in that for these
19 particular customers? Those are the customers that go
20 to AT&T for intraLATA toll that AT&T will have
21 effectively a net gain of revenue. Shouldn't that
22 factor into your analysis of the effective discount?

23 A I'm sorry, Mr. Carver, I'm not sure I
24 understood the question as you posed it.

25 Q Let me try again, and if I'm missing

1 something, you'll tell me. As I understood your
2 previous testimony, you said that there's an actual
3 discount, which you called a nominal discount, and
4 that it's not as bad as it looks because in reality
5 BellSouth is keeping the access revenues. So
6 effectively, it's really less than that 40% AT&T is
7 asking for, correct?

8 A Yes.

9 Q Now, you've also told me that customers who
10 want one-stop shopping are going to tend to go to AT&T
11 for the intraLATA toll if they have AT&T as a provider
12 of local exchange service, correct?

13 A Yes.

14 Q Now, the revenue that AT&T would gain for
15 providing the intraLATA toll service is going to be
16 greater than what they pay for the corresponding
17 access for intraLATA toll, correct?

18 A Yes. It should be.

19 Q So in that particular instance, AT&T is
20 going to have a net gain in revenue?

21 A Okay.

22 Q Now, shouldn't your effective discount also
23 factor in that in those particular instances AT&T is
24 effectively going to have an even greater discount?

25 A Not necessarily. Two reasons. One, the

1 intraLATA toll revenue is obtainable totally
2 independently of what is at issue here, so you may not
3 want to consider it because of that. But secondly,
4 it's not clear to me at all that if I were to include
5 the revenue, and then those access charges associated
6 with intraLATA toll, that the discount doesn't
7 actually go the other way.

8 In other words, it is certainly possible, if
9 not likely, that the difference between the average
10 toll revenue and the average access charge revenue for
11 intraLATA toll is less than a 40% differential; in
12 which case if I were to add that into the analysis, it
13 would actually prove my point even more. I don't know
14 what the figures are for you, but for GTE, for
15 instance, that differential is razor thin and
16 including it would prove the way I am looking at it
17 even more than the analysis I did.

18 Yours would only be true of the difference
19 between the average toll revenue and the average
20 access revenue is greater than the 40% being
21 discussed.

22 Q Well, I'm not sure I understand how the 40%
23 factors in, because the 40% again is the nominal rate.
24 That's the actual rate. Now, the situation that
25 I've -- if you want to treat it as a hypothesis,

1 that's fine. Or that I've thrown out there as a
2 hypothetical is that as a result of reselling
3 BellSouth's services, AT&T could accept a customer for
4 intraLATA toll, and the revenue that you obtain is
5 greater than the access charges you pay.

6 And you've agreed in that instance that
7 there's a net gain in revenue, correct?

8 A Yes. I'm just trying to point out that --

9 Q Okay, that's correct?

10 A That's correct.

11 Q So in this instance, BellSouth is not only
12 giving you a 40% discount, and you are not only
13 obtaining a 40% discount, but you are also getting an
14 additional revenue stream that adds to that. And it
15 doesn't move it back toward 24%, but that, in fact,
16 moves it in the other direction?

17 A No, your math is wrong. Because I not only
18 get an additional revenue, which you are considering,
19 I also incur an additional cost. So since I'm
20 changing both the numerator and the denominator here,
21 whether or not it makes the effective discount go up
22 or down depends on whether or not the difference
23 between the toll revenue, the revenue I get and the
24 cost I incur, is greater or less than the 40% or the
25 24%.

1 If it is in the 24% to 40% range, it goes
2 one way. If it's the other way, it shrinks it the
3 other way. And I don't have in front of me that data
4 to be able to answer your question.

5 Q Okay, then let's move on. Now, is it AT&T's
6 position that you should be able to buy, for example,
7 a 1-FR priced as if it were a recombination of
8 unbundled elements?

9 A No. I don't believe that you actually ever
10 get 1-FR when you buy network elements. You get the
11 ability to offer your own 1-FR, but you also become
12 the exchange access provider. So it's not the same as
13 offering your retail service, although certainly one
14 of the things that you could offer is something that
15 is similar if not identical to it.

16 Q Okay. What is the 1-FR composed of?

17 A It's has a loop, a switch, port and some
18 local usage.

19 Q Okay. Now --

20 A And it leaves BellSouth as the access
21 provider.

22 Q Okay. Let's take out the part of BellSouth
23 being the access provider. Other than that, is it
24 correct that you believe that AT&T should be able to
25 buy these component parts on an unbundled basis,

1 rebundle them into what functionally is the 1-FR, and
2 to sell it. And that rather than treating this as
3 resell service, you treat it as unbundled elements
4 that have been purchased; is that correct?

5 A Yes. But I do feel compelled to point out
6 that the only way I can say yes to this answer is he
7 starts it out by saying, "leaving aside for a moment
8 the things that make this different, are they the
9 same." And the answer to that question is, yes.
10 Leaving aside the fact that things that make it
11 different, it can be the same as your 1-FR; it can be
12 different, too.

13 Q Well, let's talk about the things that make
14 it different. You identified access. I believe it's
15 your position, isn't it, that if AT&T resells
16 BellSouth's 1-FR, you still have to pay BellSouth
17 access charges. But if you take the component parts
18 of the 1-FR, buy them as if you've unbundled, and then
19 put them back together, then you don't have to pay
20 access charges, correct?

21 A Yes. Because under one you are reselling
22 your service, under another you are buying network and
23 becoming the local telephone company.

24 Q Now, functionally, how does this work when
25 you buy these unbundled elements? Do you think AT&T

1 should have to go through the process of unbundling
2 them and getting the elements and then reconstituting
3 them? Or do you think that they should be able to
4 just call up BellSouth and say, I'd like you to sell
5 me all the component parts of the 1-FR unbundled and
6 rebundled at the cost to buy these unbundled elements,
7 and then it will just happen?

8 A All right. Obviously, it makes much more
9 sense if you order -- if you are going to use a
10 combination of network elements, you order them in the
11 form they are in. There are reasons for this. There
12 are strong public policy reasons for the Commission to
13 desire this.

14 Q So, then, your unbundled network elements
15 are not really unbundled at all. It's just sort of we
16 engage in the fiction that you've taken them apart and
17 put them back together. But, in fact, you just called
18 up BellSouth and said, "Give me a 1-FR, and I'll keep
19 the access and this is what I'll pay you," correct?

20 A No. I don't think that that's an accurate
21 statement at all.

22 Q What am I missing?

23 A First of all, they are unbundled in the
24 sense they are unbundled from your service. They are
25 now generic ingredients. Secondly, when I buy them, I

1 have fully paid you for the total cost of these
2 facilities, including in the case of the switch all
3 the features and functionalities.

4 Now, it is true that because you have to
5 make available to me all the features and
6 functionalities in your network, that one of the
7 things I can create is exactly what you offer. Now,
8 that statement would have to be true, or it would mean
9 that they could deny the entrant something. But it is
10 also true that when I buy that switch, I buy all of
11 its capabilities for a single price, which means that
12 I'm much, much more likely to not put on the market a
13 1-FR that looks like yours, but put on the market a
14 1-FR that has other elements and other features and
15 other capabilities with it, call waiting for free,
16 RingMaster -- sorry, trademark -- selective ringing,
17 as part of the service package. But, yes, I could
18 create something that looks like yours.

19 Q So apart from what you might do, what you
20 just talked about, to go back to my original question:
21 Under your analysis, the competitor, call it
22 BellSouth, and just order 1-FR, and your choice would
23 be that you could get the 1-FR and pay BellSouth
24 access. And if that's the case -- and you'd buy it at
25 the wholesale discount rate, or you could buy a 1-FR

1 that looked exactly like the other one, except you
2 didn't pay BellSouth access charges. And in that
3 example, the price would be the aggregate price of all
4 the unbundled elements, correct?

5 A I don't want to quibble with the words. It
6 isn't just ordering 1-FR.

7 Q Okay. But the bottom line is the only real
8 difference between these two, is that if you buy the
9 unbundled elements and we act like they've been taken
10 apart and put back together, then you pay a different
11 price, and you don't have to pay access, correct?

12 A No. No, there are at least three
13 differences. First, I'm buying generic
14 functionalities and I, as the purchaser of these, get
15 to decide how my 1-FR looks, what features I put on
16 it, how I price it, how I arrange for it. So it is
17 different in that dimension.

18 Secondly, I have now stepped into the role
19 of local telephone company, and I -- well, let me do
20 the second in this order.

21 Second, rather than paying you a resold rate
22 and only being partly in the local telephone business,
23 I have fully paid you the full cost of these network
24 elements, which means whether or not the customer
25 subscribes to other things or not, whether the

1 customer makes a lot of phone calls or makes few phone
2 calls, whether or not other people call them or don't
3 call them, I am paying you the full dollar value, and
4 I am carrying the risk.

5 Third, as part of being a local telephone
6 company, I am fully providing all of the services to
7 that customer, both the services that they buy from me
8 and, importantly, the access services that other
9 carriers purchase in order to reach my customer. So
10 there are three fundamental differences.

11 CHAIRMAN CLARK: Mr. Gillan, let me ask you
12 a question. I see those as three ways they could be
13 different. But as I understand the way you've
14 answered Mr. Carver's questions, the answer to his
15 question ultimately is yes.

16 WITNESS GILLAN: No.

17 CHAIRMAN CLARK: You can do that.

18 WITNESS GILLAN: No, I don't believe that is
19 true. First of all, how it could be different insofar
20 as how I structure my product, that is true. I could
21 structure it to look the same, I could structure it to
22 look differently.

23 How much I pay him, absolutely different
24 number. I don't pay him what his retail product price
25 is less some avoided costs. I pay him the full cost

1 of those network elements, likely to be -- in many
2 cases will be more money than what it would cost if I
3 was reselling 1-FR.

4 Third, this is a lot more complicated
5 business arrangement. I am not just going into the
6 business of remarketing his retail service; I am
7 becoming a local telephone company. In order to make
8 this work, I have to put in place the capability to
9 bill interexchange carriers, to track access usage, to
10 issue those bills. I have fundamentally changed the
11 type of business operation I'm engaged in.

12 Now, he's never asked me why is it
13 important, am I putting so much emphasis on this
14 ability. And unless you ask me, I won't get into it.
15 But these are not the same thing. It is a much more
16 complicated thing.

17 CHAIRMAN CLARK: And what you are saying is
18 likely the cost for each unbundled service that you
19 need to provide 1-FR will be greater than if you
20 bought 1-FR at wholesale, the bundled service at
21 wholesale. Would that be correct?

22 WITNESS GILLAN: That would be my
23 expectation.

24 CHAIRMAN CLARK: Okay.

25 Q (By Mr. Carver) Let's go back to that

1 question that Chairman Clark just asked you. Would
2 the same be true for business lines?

3 A It would be much more dependent on the
4 business usage.

5 Q Generally speaking, though, your answer
6 would be the reverse for business though; would it
7 not?

8 A I hesitate only because I haven't actually
9 looked at it.

10 Q Could you make an educated guess, or is this
11 one you would rather say you don't know to?

12 A An educated guess is just that -- it is
13 likely that they would be closer than what I see in
14 the residential market, but I don't believe that the
15 situation -- for what I would pay for these network
16 elements would necessarily be reversed.

17 I see no real reason to believe that unless
18 it's a customer, a business customer who bought -- who
19 made very, very little local calling, so all I am
20 paying for is effectively the business loop and
21 capacity in the switch.

22 Q Well, the loop price is going to be the same
23 whether you serve a residential customer or business
24 customer, correct?

25 A Yes.

1 Q Let's go back to what we were talking about
2 before about resale verses unbundled elements. And I
3 just want to get a concrete example of how this would
4 work.

5 And you told us the reasons why AT&T might
6 do particular things, but I want to focus here on what
7 they could do if they wanted to given the position
8 that you are advocating.

9 Now, let's assume that Chairman Clark was a
10 BellSouth customer, and let's assume that she decided
11 to switch to AT&T. Given the position that you
12 advocate, AT&T could just call up BellSouth and say,
13 "Chairman Clark is now my customer. I want to go
14 ahead and buy from you at a wholesale rate at the
15 wholesale discount the 1-FR that serves her
16 residence," correct?

17 A Okay.

18 Q Then you could call up the next day and say,
19 "Well, I'm still serving this new customer, but I've
20 changed my mind about how I want to go about serving
21 her. So what I want to do now, is I want you to take
22 all those elements that make up that 1-FR, unbundle
23 them, rebundle them, and charge me a different price."
24 You could do that also, couldn't you?

25 A I could order up those network elements as a

1 combination, yes.

2 Q Now, let me ask you. When AT&T orders a
3 1-FR from BellSouth, when you go through this
4 unbundling/rebundling approach, does that allow AT&T
5 to avoid the joint marketing limitation in the Federal
6 Act?

7 A I believe that it does legally.

8 Q And you know the limitation that I'm
9 speaking about, correct?

10 A Yes.

11 Q It's the -- just to clarify to make sure we
12 are on the same point, Section 271 of the Federal Act
13 says, and I'll paraphrase here rather than reading the
14 whole paragraph: Basically, that if a carrier serving
15 more than 5% of the nation's presubscribed access
16 lines buys services to resell, then you can't joint
17 market those with your interLATA service until either
18 a Bell operating company is authorized to provide the
19 service or 36 months have passed.

20 Is that pretty much an accurate statement of
21 what it says?

22 A That's my recollection of it, yes.

23 Q And if your opinion, if AT&T rather than
24 reselling the service said give me an 1-FR on an
25 unbundled/rebundled no access charge basis, then they

1 would also be able to joint market the local service
2 that they provide with your intraLATA toll despite the
3 limitation in the Act; is that correct?

4 MS. DUNSON: Madam Chairman, I would just
5 like to point out that Mr. Gillan is not a lawyer.
6 And to the extent that Mr. Carver is asking him to
7 reach a legal conclusion on the interpretation of the
8 Act, I would like to object to that extent.

9 MR. CARVER: Well, first of all, Mr. Gillan
10 has offered a lot of opinions about what the Act
11 means. I think that's a large portion of why he's
12 here. If he doesn't know the answer to my question,
13 he can say that. But I think I'm at least entitled to
14 answer the question. And actually, I think he's
15 already answered it once. I'm just trying to clarify
16 what his answer is.

17 CHAIRMAN CLARK: With the understanding he
18 is not a lawyer, I think he can answer the actual
19 questions as to what it may mean in its
20 implementation.

21 Q (By Mr. Carver) Would you like to hear the
22 question again?

23 A No. Let me try to answer. AT&T is not
24 subject to a joint marketing restriction that applies
25 to ever form of entry. It applies only to the resale

1 of local exchange service. This form of entry, I
2 believe, would not be subject to that joint marketing
3 restriction.

4 Q So to make sure we are clear on the
5 specific, the unbundled/rebundled 1-FR, you could
6 joint market that with your intraLATA services,
7 correct?

8 A The combination of network elements, yes.

9 MR. CARVER: Thank you. That's all I have.

10 CHAIRMAN CLARK: All right. We will take a
11 break until 20 minutes to 2:00 and then we will begin
12 with Staff cross examining. Thank you.

13 (Brief recess.)

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15 (Transcript continues in sequence in Volume
16 2.)

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