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January 28, 2004

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Re: Docket Nos. 030851-TP

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are original and 15 copies of the Surrebuttal Testimony of Ben Johnson, Ph.D.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Sincerely,

Charles J. Beck
Deputy Public Counsel

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I HEREBY CERTIFY that a copy of the foregoing Surrebuttal Testimony of Ben Johnson, Ph.D. has been furnished by U.S. Mail or hand-delivery to the following parties on this 28th day of January, 2004.


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ORIGINAL

BEFORE THE FLORIDA
PUBLIC SERVICE COMMISSION

In re: Implementation of requirements)
arising from Federal Communications)
Commission's triennial UNE review: Local) Docket No. 030851-TP
Circuit Switching for Mass Market)
Customers)

Surrebuttal Testimony of

Ben Johnson, Ph.D.

Ben Johnson Associates, Inc.

on behalf of the

Citizens of the State of Florida

January 28, 2004

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of
Ben Johnson, Ph.D.

Docket No. 030851-TP

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EXHIBITS:

Exhibit BFJ-3: Matrix of Intervenor Proposals Regarding Market Definition

1 **Introduction**

2

3 **Q. Would you please state your name and address?**

4 A. Ben Johnson, 2252 Killlearn Center Boulevard, Tallahassee, Florida 32309.

5

6 **Q. Are you the same Ben Johnson who earlier filed rebuttal testimony in this proceeding?**

7 A. Yes, I am.

8

9 **Q. Does your surrebuttal testimony include any Exhibits?**

10 A. Yes. Exhibit BFJ-3 summarizes the positions taken by the parties filing testimony in this
11 proceeding on the issue of the appropriate definition of a market.

12

13 **Q. What is your purpose in filing this surrebuttal testimony?**

14 A. In this filing I will respond to the rebuttal testimonies of BellSouth Telecommunications, Inc.
15 witness Pleatsikas, Florida Competitive Carriers Association (FCCA) witness Gillan, MCI
16 Worldcom Communications, Inc. (MCI) witness Bryant, Sprint-Florida/Sprint Communications
17 LP (Sprint) witness Staihr, and Verizon Florida Inc. witnesses Fulp and Taylor. These parties
18 (“listed parties”) addressed issues I discussed in my rebuttal testimony. Due to time and
19 resource constraints, I have not attempted to address each and every point included in their
20 testimonies, particularly since many of their arguments were already dealt with in my rebuttal
21 testimony. Instead, I will take this opportunity to clarify my recommendations, and to emphasize
22 the risks associated with the alternatives advocated by the listed parties. The fact that I do not

1 discuss other portions of their rebuttal testimonies should not be construed as agreement with
2 such testimony.

3

4 **Q. How is your testimony organized?**

5 A. I first very briefly restate the major points in my rebuttal testimony, and discuss whether, and to
6 what extent, these points were addressed in the rebuttal testimonies of the listed parties. I then
7 respond, in turn, to the listed parties' rebuttal testimonies concerning three main issues: (1)
8 market definition; (2) the breakpoint between the mass market and the enterprise market; and
9 (3) the distinction between residence and business product markets.

10

11 **Major Points in Rebuttal Testimony**

12

13 **Q. To place the listed parties' rebuttal testimonies into context, can you please briefly**
14 **describe the major points included in the rebuttal testimony you filed on January 7,**
15 **2004?**

16 A. Yes. My rebuttal testimony centered on three major themes. First, I stressed the importance of
17 properly defining the market, and the risk of inadvertently reaching conclusions concerning
18 impairment that are valid for some mass market customers but are not valid for others.
19 Geographic market definitions like MSAs, CEAs and UNE rate zones are too broad. Among
20 other problems, these proposals greatly increase the risk of inadvertently reaching a conclusion
21 of non-impairment that is only valid with respect to a portion of a geographic area—a conclusion
22 that is not valid for other portions of that area.

1 Second, the Commission is obligated to set a breakpoint to distinguish between
2 customers in the mass market and those in the enterprise market. I alerted the Commission to
3 the lack of guidance that the FCC provided in its TRO regarding this issue. In response to the
4 testimony of Sprint witness Dickerson, suggesting a breakpoint of 12 lines, I cautioned the
5 Commission that a higher cut-over tends to classify more customers as being in the “mass
6 market.” As noted by the FCC, with a higher breakpoint, “it is more likely that there will be a
7 finding of no impairment for the entire market,” and there will be “significantly less unbundled
8 switching than was available under [a] four-line carve-out.” [TRO, supranote 1546]

9 Third, considering differences in revenue and profit levels, residential and small business
10 mass market customers should be studied separately, to the extent feasible. In its TRO, the
11 FCC recognized the potential importance of demand differences (e.g., average revenue levels)
12 and it asked state commissions to perform granular analyses. If these important differences
13 between residential and small business mass market customers are completely ignored, the
14 impairment analysis may not be sufficiently granular, or it may reach conclusions that are only
15 valid for some small business customers—conclusions that are not valid for most residential and
16 smaller business customers.

17

18 **Q. Did any of the listed parties address these issues in their rebuttal testimony?**

19 **A.** Yes, many of these issues were discussed by the listed parties in their rebuttal testimony.

20

21

22

1 **Market Definition**

2
3 **Q. Which of the listed parties, in their rebuttal testimonies, took a stance contrary to your**
4 **own regarding the issue of market definition?**

5 A. BellSouth witness Pleatsikas, Sprint witness Staihr, Verizon witness Taylor, and FCCA witness
6 Gillan testified in favor of broad geographic market definitions, and against narrow market
7 definitions, although they were not in agreement as to the appropriate broad definition.

8
9 [Dr. Bryant's wire center] aggregation is not reasonable because it
10 does not sufficiently consider substitutability in supply. That is, it fails to
11 consider whether efficient competitors using self-provisioned (or
12 third-party) switching to provide service in certain wire centers could,
13 within a sufficiently short period of time, render supracompetitive
14 pricing by the incumbent in another, proximate wire center unprofitable
15 (i.e., because a sufficient number of the incumbent's customers would
16 switch to one of the competitors in response to such pricing). ... In fact,
17 the scale and scope economies available to efficient entrants (TRO fn.
18 1536) are generally not consistent with the existence of narrow
19 geographic markets defined along wire center boundaries. [Pleatsikas
20 Rebuttal, p. 6]
21

22 That urban/rural distinction is one of the key reasons why Sprint's
23 proposed market definition (MSA) is a more accurate market
24 definition, because in general MSAs are the more urban areas and
25 non-MSAs are the more rural areas. ... The BellSouth proposal to treat
26 different portions of the CEA differently, based on UNE zones,
27 essentially negates this community-of-interest aspect. Whereas using the
28 MSA as the market maintains the community-of-interest aspect. [Staihr
29 Rebuttal, pp. 2-3, 4]
30

31

1 Based on sound economic principles and a number of FCC policy
2 statements I conclude-contrary to the position of interveners-that the
3 relevant geographic market is the MSA, not the individual wire center
4 nor the undefined geographic area implied by Mr. Gillan's incorrect and
5 novel notion. In this section I provide the basis for my conclusion.
6 [Taylor Rebuttal, p. 9]
7

8 I recommend that the Commission use LATAs to evaluate impairment.
9 As I noted repeatedly above, the mass market is spread throughout
10 BellSouth's service territory in Florida and any lesser area could
11 potentially camouflage the importance of this fact. However, the
12 evidence (see Table 2) suggests that each LATA is sufficiently
13 comparable to the state overall that the Commission's analysis would
14 not be distorted by using these pre-existing areas in its analysis. [Gillan
15 Rebuttal, p. 15]
16

17 **Q. Have you summarized these and other intervenor positions on the appropriate market**
18 **definition to use in this proceeding?**

19 A. Yes, my Exhibit BFJ-3 contains a table which places each intervenor's market definition
20 proposal into one or more columns. As the quotes just cited confirm, I have placed Dr.
21 Pleatsikas's name into the column labeled "UNE Zones within Component Economic Area
22 (CEA)." I have placed Dr. Staihr's name into the column labeled "Metropolitan Statistical
23 Area (MSA)." I have placed Mr. Taylor's name into the column labeled "UNE Zones within
24 MSA." And I have placed Mr. Gillan's name into the column labeled "Local Access and
25 Transport Area (LATA)."
26

27 **Q. Can you briefly respond to this portion of Dr. Pleatsikas's rebuttal testimony?**

28 A. Yes. Dr. Pleatsikas attacks Dr. Bryant's recommendation that wire centers be aggregated into

1 geographic market, yet this concept is directly analogous to the approach that is employed in
2 the Department of Justice (DOJ) and Federal Trade Commission's (FTC) Horizontal Merger
3 Guidelines (HMGs). Recall that the approach to defining a geographic market was described
4 in the HMGs as follows.

5
6 In defining the geographic market or markets affected by a merger, the
7 Agency will begin with the location of each merging firm (or each plant
8 of a multiplant firm) and ask what would happen if a hypothetical
9 monopolist of the relevant product at that point imposed at least a
10 "small but significant and nontransitory" increase in price, but the terms
11 of sale at all other locations remained constant. If, in response to the
12 price increase, the reduction in sales of the product at that location
13 would be large enough that a hypothetical monopolist producing or
14 selling the relevant product at the merging firm's location would not find
15 it profitable to impose such an increase in price, then the Agency will
16 add the location from which production is the next-best substitute for
17 production at the merging firm's location. [Id.]
18

19 The substitutability of supply to which Dr. Pleatsikas refers is inherently considered in the "start
20 small and build up" approach used by the DOJ/FTC. In order to define a market in this
21 proceeding, the Commission should start with a wire center and add to it other wire centers
22 with homogeneous characteristics. While there is some merit to trying to determine the point at
23 which "efficient competitors using self-provisioned (or third-party) switching... could... render
24 supracompetitive pricing by the incumbent... unprofitable" there is absolutely no basis for
25 assuming that point is determined by any preexisting large geographic boundary such as a
26 LATA, an MSA or a CEA. To the contrary, the only logical way to find that point is to
27 carefully evaluate the relevant market conditions present in each wire center or small group of

1 wire centers.

2 Oddly, Dr. Pleatsikas seems to concede the relevance of market conditions within each
3 wire center (or homogeneous group of wire centers) at a later point in his rebuttal testimony:

4
5 As I noted, the competitive entry decision occurs at the market level
6 (which generally would span several wire centers) even if a particular
7 CLEC may elect not to enter a particular wire center (immediately or
8 ever). Accordingly, and in contrast to Dr. Bryant's proposal, a
9 reasonable way of determining whether a particular wire center should
10 be included in a more broadly defined market area depends on whether
11 that wire center's relevant economic/financial characteristics are
12 reasonably homogeneous with those of other proximate wire centers. If
13 they are, then the wire center should generally be included in that
14 broader market area. [Pleatsikas Rebuttal, p. 16]

15
16
17 As I read this statement, it appears that Dr. Pleatsikas realizes that a small group of wire
18 centers with homogeneous characteristics could, as I propose, constitute a valid geographic
19 market definition. In some cases the resulting market area might be similar to the market
20 definitions proposed by BellSouth (UNE rate zones divided by Component Economic Areas),
21 but in other cases they might differ substantially (because market conditions are not necessarily
22 homogenous throughout a CEA).

23 As for Dr. Pleatsikas's contention that CLECs cannot adequately achieve economies of
24 scale and scope in individual or groups of wire centers, I would first note that BellSouth and
25 other parties to this proceeding have not offered any studies to demonstrate the extent to which
26 CLECs can or cannot achieve "scale and scope economies" within individual wire centers, or
27 small groups thereof.

1 Properly conducted, such a study would consider not only the degree to which
2 economies can be achieved within a particular market, but also the extent to which additional
3 scale and scope economies can be achieved when serving the specified market while also
4 serving other markets. Stated differently, scope economies are frequently achieved by selling
5 goods and services in multiple distinct markets.

6 In general, as a matter of sound economic reasoning it isn't valid to reject a particular
7 set of market definitions merely because this set of definitions separates geographic markets that
8 are distinct from a demand perspective, yet are interrelated from a supply perspective. For
9 instance, the Miami - New York air travel market can legitimately and appropriately be
10 separated from the Miami - Orlando air travel market and the Orlando - New York air travel
11 market. These definitions are valid notwithstanding the fact that airlines may achieve additional
12 economies of scale and scope if they decide to serve all three of these markets (e.g., by
13 scheduling planes to fly triangular routes from Miami to New York to Orlando to Miami and
14 from Miami to Orlando to New York to Miami).

15 While the TRO requires consideration of potential economies of scale and scope, there
16 is no indication that the FCC requires the Commission to artificially ignore the potential for
17 cross-market efficiencies, nor does the TRO state that each individual geographic market must
18 be large enough to exhaust all potential economies of scale and scope, without regard to the
19 physical proximity of other markets, or the potential for achieving additional economies of scale
20 and scope across multiple markets.

21
22

1 **Q. Can you briefly respond to the quoted portion of Dr. Staihr’s rebuttal testimony?**

2 A. Yes. Dr. Staihr apparently is under the impression that MSAs are uniformly “urban or
3 suburban.” This is not the case. To the contrary, they frequently include rural areas, as well.
4 The Office of Management and Budget (OMB), the government agency responsible for
5 developing MSAs, has cautioned that they are not exclusively urban in character:

6
7 The Metropolitan and Micropolitan Statistical Area Standards do not
8 equate to an urban-rural classification; all counties included in
9 Metropolitan and Micropolitan Areas and many other counties contain
10 both urban and rural territory and populations. [Id.]
11

12 Collectively, the OMB refers to Metropolitan and Micropolitan Statistical Areas as Core Based
13 Statistical Areas (CBSAs). The OMB further states:

14
15 Program designs that treat all parts of a CBSA as if they were as urban
16 as the densely settled core ignore the rural conditions that may exist in
17 some parts of the area. [Federal Register, Vol. 65, No. 249,
18 Wednesday, December 27, 2000]
19

20 While I agree that MSAs often reflect a significant “community-of-interest aspect” that doesn’t
21 mean they are economically homogeneous. Because an MSA includes “a recognized population
22 nucleus,” it will invariably include a substantial urban component. [Federal Register, Vol. 65,
23 No. 249, Wednesday, December 27, 2000] Since most urban areas include a suburban fringe
24 of bedroom communities, a typical MSA includes a mixture of both urban and suburban
25 markets. Furthermore, in a state like Florida, which includes many rural area., an MSA may
26 include miles of lightly populated rural areas beyond the suburbs.

1 starting with a large geographic area like an MSA does not comply with the “smallest market”
2 principle that lies at the heart of the HMGs. Mr. Taylor and I are in agreement that the HMGs
3 are consistent with sound economic theory; where we disagree is with our interpretation of the
4 HMGs; I believe a fair reading of the HMGs confirms that the FTC/DOJ approach is more
5 consistent with an approach that starts with an individual wire center then adds other nearby
6 wire centers with homogenous characteristics; it is not consistent with an approach that simply
7 chooses amongst large “off the shelf” geographic areas like CEAs, MSAs or LATAs.

8 I have already refuted Mr. Taylor’s second and third points, regarding fulfillment of
9 TRO guidelines and CLEC entry and advertising patterns, in my rebuttal testimony. I will
10 concede that CLECs do not generally announce the details of their business plans and market
11 entry strategies, a point that was emphasized by Dr. Pleatsikas in his rebuttal testimony.
12 [Pleatsikas Rebuttal, p. 9] However, in Michigan Case No. U-13796, a witness for a CLEC,
13 Sage Telecom, Inc., testified that it does not analyze markets or make entry decisions on the
14 basis of broad MSAs:

15
16 **Q. Does Sage Market its UNE-P based services to**
17 **customers in Michigan based on the Metropolitan**
18 **Statistical Areas defined by the U.S. Office of**
19 **Management and Budget?**

20 A. No.

21
22 **Q. To your knowledge, does anyone in the Michigan**
23 **telecommunications industry market its services to**
24 **customers in Michigan based on the Metropolitan**
25 **Statistical Areas defined by the U.S. Office of**
26 **Management and Budget?**

27 A. No, they do not. In fact, nearly all of those providing basic local

1 exchange in Michigan, including SBC, market their services
2 based on exchange areas, because central office services,
3 switching, provision of NXXs, and local calling areas are all
4 based on exchange areas. Some carriers appear to market
5 based on wider amalgamations of exchange areas, such as
6 LATAs or Number Plan Areas (also known as Area Codes or
7 NPAs”). [McCausland Direct, Sage Telecom, Inc., Case No.
8 U-13796, December 19, 2003, p. 16]
9

10 Mr. Taylor’s fourth contention is that prior FCC use of MSAs validates their use in this
11 proceeding. I disagree. The FCC has never utilized MSAs in a context like the present one. I
12 concede the FCC has used MSAs for a variety of different analytical purposes, but those
13 proceedings involved entirely different circumstances and issues than are present in this
14 proceeding. Cases related to telephone numbers portability, ILEC mergers, and pricing
15 flexibility for interstate services all involve factual issues that do not vary greatly from wire
16 center to wire center within an MSA. In the context of this proceeding, however, it is not
17 sufficient to speak of the “local exchange market” generally. In this context, the appropriate
18 geographic market relates to a CLEC’s ability to use its own switching facilities to serve mass
19 market customers, and that can vary widely depending upon the circumstances applying to each
20 wire center (e.g., the availability of collocation facilities and the number of enterprise customers
21 present in each wire center).

22
23 **Q. Can you briefly respond to Mr. Gillan’s rebuttal testimony?**

24 **A.** Yes. Mr. Gillan’s proposal is deeply flawed, and creates very high risks for consumers. Local
25 Access and Transport Areas (LATAs), which were initially designated at the end of the AT&T

1 antitrust case, are even larger geographic areas than MSAs. There are 10 LATAs in Florida,
2 collectively encompassing the entire state. Because LATAs are so vast and heterogenous, they
3 are effectively very similar to defining the entire state as a single market. In the quote above,
4 Mr. Gillan apparently views this as a virtue, noting that a LATA is “sufficiently comparable” to
5 the state as a whole.

6 Recall that the TRO explicitly prohibits defining an entire state as a single market. By
7 utilizing LATAs, Mr. Gillan is offering an approach that avoids this legal prohibition while
8 ensuring a similar end result. LATAs are very heterogeneous, virtually guaranteeing that each
9 market will include a mixture of different circumstances and areas, ranging from places where
10 high levels of impairment exist, to areas where little or no impairment is present.

11 With such a broad geographic market definition, the Commission is forced into an all-
12 or-nothing choice: either the entire LATA will be declared off-limits to competition from CLEC
13 that depend on unbundled switching (because the “trigger” has been pulled in a portion of that
14 vast area), or UNE-P will be preserved throughout the entire LATA because the absence of
15 impairment does not uniformly exist throughout the entire LATA. Perhaps from his clients’
16 perspective an all-or-nothing dichotomy may seem like a reasonable (albeit high stakes)
17 gamble. But from the perspective of customers, it is far too risky an approach. The competitive
18 alternatives available to millions of customers may shrink or disappear if this approach is
19 followed and it is determined that the “trigger” conditions have been fulfilled within a portion of
20 the LATA.

1 **Mass Market/Enterprise Market Breakpoint**

2
3 **Q. Would you like to respond to any of the rebuttal testimony regarding the breakpoint**
4 **between the mass market and the enterprise market?**

5 A. Yes. Verizon witness Fulp, and FCCA witness Gillan testify as follows:

6
7 A fixed crossover point based on a pre-determined number of analog
8 lines, based on some calculation of average costs, would ignore the
9 actual economic choices made by the CLECs and their customers. As I
10 explained in my direct testimony, the Commission should establish that
11 mass market customers are those customers that are actually being
12 served with one or more voice grade DS0 circuits, while enterprise
13 customers should be those customers actually being served by DS1 or
14 higher capacity loops. [Fulp Rebuttal, p. 6]
15

16 In the Verizon territory, I recommend that the Commission accept
17 Verizon's proposal to not impose an artificial upper bound to the mass
18 market. ... Where the ILEC insists that the Commission establish a
19 regulatory "cap" on the mass market, the basic principles on how such
20 a cap should be calculated were included in my direct testimony. My
21 review of the testimony of Sprint's witness Kent Dickerson indicates
22 that Sprint's calculation conforms to those principles and I would
23 recommend the Commission adopt a crossover of 12 lines for the
24 territories of Sprint and BellSouth. [Gillan Rebuttal, p. 16]
25

26 To varying degrees Mr. Fulp and Mr. Gillan argue that the Commission should not use
27 the FCC's default breakpoint of four lines, and that it is not necessary to choose a specific
28 (uniform) alternative. Instead, they suggest the Commission should define the mass market as all
29 customers that are served using analog DS0s. This is an intriguing approach, since it relies on
30 actual customer data, rather than a uniform breakpoint. However, it isn't explicitly permitted

1 under the TRO. The TRO reads in part:

2
3 Therefore, as part of the economic and operational analysis discussed
4 below, a state must determine the appropriate cut-off for multi-line DS0
5 customers as part of its more granular review. This cross over point
6 may be the point where it makes economic sense for a multi-line
7 customer to be served via a DS1 loop. We expect that in those areas
8 where the switching carve-out was applicable (i.e., density zone 1 of
9 the top 50 MSAs), the appropriate cutoff will be four lines absent
10 significant evidence to the contrary. We are not persuaded, based on
11 this record, that we should alter the Commission's previous
12 determination on this point. Accordingly, we authorize the states, within
13 nine months of the effective date of this Order, to determine the
14 appropriate cross over point. [TRO, ¶ 497]
15

16 At least on its face, this language seems to contemplate defining the mass market on the basis of
17 a specific cut-over point or dividing line—the “point where it makes economic sense for a
18 multi-line customer to be served via a DS1 loop.” The TRO seems to provide some flexibility
19 in defining this point, allowing, for example, consideration of a variety of different revenue and
20 cost data. However, the FCC clearly seems to contemplate a breakpoint that corresponds to a
21 conceptual dividing line, rather than simply sorting customers into markets on the basis of their
22 historic serving arrangements. Thus, for example, if a large bank continues to be served with
23 hundreds of analog PBX trunks, this would not be sufficient to cause the bank to be classified
24 as a “mass market” customer. Interestingly, while Mr. Gillan agrees with classifying customers
25 on the basis of their actual serving arrangements in the case of Verizon, for BellSouth he
26 recommends adopting a breakpoint of 12, as developed in the study conducted by Sprint
27 witness Dickerson.

1 **Q. What is the impact of using a breakpoint of 12 rather than the FCC’s default**
2 **assumption?**

3 A. The immediate impact is that a larger number of customers will be classified as falling within the
4 “mass market” and fewer will be treated as “enterprise” customers. The ultimate impact will
5 depend on the geographic market definitions adopted by the Commission, as well as the
6 specific criteria that are used by the Commission in reaching its final conclusions concerning
7 whether or not impairment exists.

8 In general, a high breakpoint increases the number of risks facing residential consumers
9 in this proceeding. With a high breakpoint and large geographic market areas, the likelihood
10 increases that millions of residential customers will no longer be provided with any competitive
11 options, or they will have fewer competitive choices, as a result of decisions made in this
12 proceeding. This follows directly from the fact that CLECs that are using their own switches
13 tend to focus on larger business customers; the smaller the customer, and the lower the revenue
14 provided by the customer, the less likely they will be able to serve that customer using their own
15 switch. With a high breakpoint, the likelihood increases that the Commission will conclude the
16 “trigger” has been pulled due to CLEC activity that has spilled over from the enterprise market
17 into the high end of the mass market. In turn, this could lead to a finding of “no impairment”
18 throughout the entire geographic market, despite the fact that no CLECs are economically
19 capable of, or willing to, serve low-revenue customers (e.g. very small business and residential
20 customers) within that market. As a result, competitive options for residential customers will
21 diminish or disappear, because CLECs will no longer be able to use unbundled switching to
22 serve these smaller customers, and they may not be able to use their own switching facilities to

1 do so.

2

3 **Demand-Based Market Distinctions**

4

5 **Q. In their rebuttal testimony, do any of the other witnesses criticize the concept of**
6 **distinguishing between business and residence product markets?**

7 A. Yes. Verizon witness Taylor states as follows:

8

9 In the first place, the TRO makes it clear that the product market the
10 FCC considers relevant for applying its triggers is mass-market local
11 exchange service, irrespective of whether the customers are business or
12 residential: [Quotes cited] [Taylor Rebuttal, p. 36]

13

14 Second, from an economic perspective, the fact that residential and
15 business customers pay different prices for basic service does not imply
16 that those customers purchase services in different markets. ... In other
17 words, Dr. Bryant overlooks the fact that the price differences between
18 residential and business services are the result of public policy and not
19 private profit-maximization, and thus those price differences, by
20 themselves, do not imply that residential and business customers
21 occupy different product markets under the Merger Guidelines'
22 standard. [Id., pp. 37, 39]

23

24 Third, the TRO, itself, outlines some of the economic reasons why all
25 mass-market customers, business and residence alike, belong in the
26 same product market for the purpose of its trigger analysis. In ¶ 459,
27 the FCC spells out the characteristics of these customers that place
28 them in a distinct product market: they are served by DS0 technology,
29 they have small accounts, and they purchase service month-to-month
30 rather than using a term discount. In addition, such customers are
31 served through customer service centers rather than individual customer
32 representatives, their services are marketed using mass-market media

1 rather than individual, customer-specific marketing, and they buy simple
2 tariffed services rather than packages of network services solicited by
3 formal Requests for Proposals. Residential and business mass-market
4 customers are served using the same technologies (circuit switches and
5 DS0 loops), and thus any supplier of mass-market business services
6 offers and can supply mass-market residential services if a profitable
7 opportunity arises. [Id., p. 39]
8

9 **Q. What is your response?**

10 **A.** None of these quotes from the TRO precludes the possibility of analyzing residential and
11 business customer data separately, or viewing these customers as purchasing telecom services
12 in separate product markets. In fact, I presented a very similar quote in my rebuttal testimony
13 from ¶ 127 of the TRO. In this passage, the FCC discusses the tight profit margins associated
14 with serving smaller customers. This is a crucially important point—one that Dr. Bryant made in
15 his rebuttal testimony.

16 Because business customers generally produce more revenue than
17 residential customers under current pricing practices, a larger
18 proportion of business customers means a larger potential revenue
19 stream for the CLEC. Likewise, the demographic characteristics of the
20 wire center may affect the potential revenue available to the CLEC. A
21 wire center with a large proportion of affluent customers, or a wire
22 center with a large proportion of younger, more tech-savvy customers
23 will likely generate more revenue per customer than wire centers
24 without these characteristics. [Bryant Rebuttal, p. 5]
25
26

27 The tighter profit margins associated with serving residential customers have steered most
28 switch-based CLECs into serving predominantly business customers. In turn, this suggests that
29 important differences may exist between impairment conditions for business and residential

1 mass market customers—differences that could be overlooked if these customer groups are
2 lumped together throughout the Commission’s decision making process.

3 Unless differences in customer characteristics and gross profit margins are adequately
4 considered, conclusions concerning impairment may be reached by the Commission that are
5 only valid for a minority of the mass market customers. For instance, a finding of non-
6 impairment may be reached based on evidence that is only valid with respect to higher revenue
7 small business customers—evidence that isn’t valid for lower revenue customers (e.g. those
8 customers generating less than \$80 per month) . Yet, the latter group may include the vast
9 majority of all customers in Florida. Stated another way, unless the Commission takes care to
10 examine data separately for residential customers, or low revenue customers, it may reach
11 conclusions about impairment that are not valid for those customers. This problem is a serious
12 one, since it involves the risk of reaching invalid conclusions for the great majority of all
13 customers in the state.

14 I also disagree with Mr. Taylor’s contention that “price differences between residential
15 and business services... do not imply that residential and business customers occupy different
16 product markets under the Merger Guidelines’ standard.” It is true that residential customers
17 pay lower prices than business customers in part due to public interest considerations
18 (particularly the universal service goal). But “the price differences between residential and
19 business services” are not exclusively the result of public policy considerations, nor are they
20 necessarily inconsistent with private profit-maximization. For instance, private
21 profit-maximization efforts in the airline industry have led to wide discrepancies between
22 business and leisure fares. Hence, for many purposes it is appropriate to distinguish between the

1 business and leisure travel markets. Furthermore, the mere fact that price differences are partly
2 due to public policy considerations does not eliminate the relevance of those pricing differences
3 for analytical purposes, nor does it imply that residential and business services cannot
4 legitimately be classified as occupying different product markets under the Merger Guidelines'
5 standard.

6 Finally, it is worth noting that in at least one point in the TRO, the FCC seems to
7 suggest that state commissions may refine their market definitions in a manner than ensures an
8 appropriate final conclusion:

9
10 In circumstances where switch providers (or the resellers that rely on
11 them) are identified as currently serving, or capable of serving, only part
12 of the market, the state commission may choose to consider defining
13 that portion of the market as a separate market for purposes of its
14 analysis. [TRO, supranote 1552]
15

16 In addition to resolving the issue of geographic market definitions, the Commission must
17 decide on an appropriate way to distinguish the mass market from the enterprise market, to
18 ensure that the final conclusions are consistent with the overall purpose of the proceeding. In
19 fact, the FCC seems to recognize, at least obliquely, that for some purposes it may be useful to
20 stratify markets with reference to customer characteristics. Consider for instance, this passage:

21
22 As discussed above, the record does not contain sufficient detail
23 concerning which geographic and **customer** markets may in fact allow
24 economic entry. In addition, impairments that exist today in certain
25 markets may be remedied in the future due to the implementation of a
26 batch cut process, as discussed above. Because our standard and the
27 guidance from the *USTA* decision require that the determination of

1 impairment be made on a granular basis, and because the record
2 provides insufficient evidence concerning the characteristics of
3 particular markets, we find it appropriate to ask the states to assess
4 impairment in the mass market on a market-by-market basis. [TRO pp.
5 493, emphasis added]
6

7 **Q. Has the FCC recognized that customer characteristics may impact the presence or**
8 **absence of impairment?**

9 **A.** Yes. For instance, the FCC recognized that customer-specific factors can influence whether or
10 not impairment exists:

11
12 Mass market customers consist of residential customers and very small
13 business customers. Mass market customers typically purchase
14 ordinary switched voice service (Plain Old Telephone Service or
15 POTS) and a few vertical features. Some customers also purchase
16 additional lines and/or high speed data services. Although the cost of
17 serving each customer is low relative to the other customer classes, the
18 low levels of revenue that customers tend to generate create tight profit
19 margins in serving them. The tight profit margins, and the price
20 sensitivity of these customers, force service providers to keep per
21 customer costs at a minimum. Profits in serving these customers are
22 very sensitive to administrative, marketing, advertising, and customer
23 care costs. These customers usually resist signing term contracts. [Id., ¶
24 127]
25

26 In this passage, the FCC recognizes that profit margins in serving smaller customers are
27 tighter than those available when serving larger customers, and this clearly has important
28 implications in determining whether or not impairment exists. While the FCC didn't focus
29 specifically on differences in average revenues per line or per customer, the overall thrust of this
30 reasoning is consistent with an approach which draws such a distinction. As the revenue per

1 customer declines, it becomes less and less feasible to profitably serve a customer using a
2 CLEC's own switch, because insufficient profit margins exist to overcome the fixed (per-
3 customer) costs of providing service using the CLEC's own facilities.

4 For this reason, one would anticipate that relatively few CLECs will serve residential
5 customers using their own switches. Rather, CLECs that use their own switches primarily focus
6 on serving larger customers—those generating much higher revenues per customer. As the FCC
7 has recognized:

8
9 ...although serving these customers is more costly than mass market
10 customers, the facts that enterprise customers generate higher revenues,
11 and are more sensitive to the quality of service, generally allow for
12 higher profit margins.” [Id., ¶ 128]
13

14 Unless these differences in customer characteristics and gross profit margins are
15 adequately considered, there is a great risk of inadvertently reaching conclusions concerning
16 impairment that are only valid for mass market small business customers—conclusions that are
17 not valid for residential customers.

18
19 **Q. Do you have any recommendations with regard to the distinction between residential**
20 **and business (or low and high revenue) customers?**

21 **A.** Yes. To the extent it is legally permissible, it could be helpful to stratify each geographic market
22 in order to analyze business and residential customer data separately. If this is done, data
23 relating to whether or not impairment exists could be analyzed separately with respect to
24 business and residential customers. Thus, for example, even if there is reason to believe a

1 “trigger” has been pulled (due to the presence of multiple CLECs) for the small business market
2 or segment, this shouldn’t automatically force the Commission to conclude that the “trigger” has
3 also been pulled for the residential market or segment.

4 Another option would be to further subdivide markets on the basis of revenue per
5 customer, or on the basis of gross profit margin per customer (revenues minus direct costs), to
6 the extent this is necessary to ensure that a finding of non-impairment is not erroneously applied
7 to customers that cannot feasibly be served using a CLEC’s own switch. This could lead to
8 more accurate and homogenous market classifications than a system based purely on the
9 number of lines used by each customer (e.g., the number of DS0 lines).

10 For instance, if the Commission concluded that customers generating revenue of less
11 than \$80 per month cannot feasibly be served using a CLEC’s own switch, it could potentially
12 segregate these customers from the remainder of the “mass” market, at least within certain
13 geographic markets. A revenue-based distinction might enable the Commission to take into
14 account differences in underlying market conditions, including typical rate structures, rate levels,
15 and gross profit margins associated with different types of customers. This is consistent with
16 language in the TRO that requires state commissions to take into account “the variation in
17 factors affecting competitors’ ability to serve each group of customers, and competitors’ ability
18 to target and serve specific markets economically and efficiently using currently available
19 technologies.” [Id., ¶ 495]

20 Regardless of what specific approach the Commission ultimately adopts, it should take
21 great care to ensure that its decisions do not prevent CLECs from serving low revenue
22 customers. CLECs should be allowed to continue using switching UNEs to serve low revenue

1 customers if it isn't economically feasible for them to serve these customers using their own
2 switch.

3

4 **Q. Does this complete your surrebuttal testimony that was prefiled on January 28, 2004?**

5 **A. Yes, it does.**

Matrix of Intervenor Proposals Regarding Market Definition

Parties Recommending Specific Geographic Markets

Party	Network Interface Device	Individual Wire Center	Cluster of Wire Centers	Metropolitan Statistical Area (MSA)	UNE Zones within MSA	UNE Zones within Component Economic Area (CEA)	Local Access and Transport Area (LATA)
MCI	Bryant Direct, p. 40	Bryant Direct, p. 2					
Supra		Nilson Rebuttal, p. 25					
State of Florida		Johnson Rebuttal, p. 19	Johnson Rebuttal, p. 20				
Sprint				Staihr Direct, p. 4			
Verizon				Flup Direct, p. 8			
Verizon					Taylor Rebuttal, p. 23		
Bellsouth						Pleatsikas Direct, p. 4	
FCCA							Gillan Rebuttal, p. 3

Parties Discussing Market Definition But Not Recommending Specific Geographic Markets

AT&T (Bradbury)
 AT&T (Wood)
 Newsouth (Jennings)
 FDN (Gallagher)
 Z-Tel (Reith)