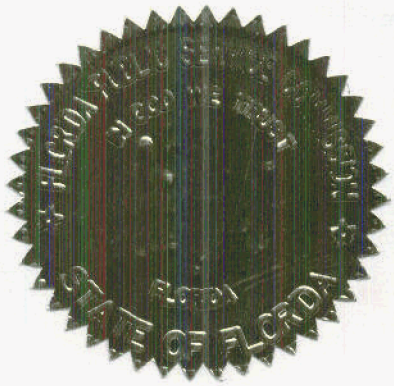
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of	**DOCKET NO. 960786-TL**
Consideration of BellSouth Telecommunications, Inc.'s Entry into interLATA services pursuant to Section 271 of the Federal Telecommunications Act of 1996.	



FIFTH DAY - MORNING SESSION

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PROCEEDINGS:	**HEARING**
BEFORE:	CHAIRMAN JULIA L. JOHNSON COMMISSIONER J. TERRY DEASON COMMISSIONER SUSAN F. CLARK COMMISSIONER DIANE K. KIESLING COMMISSIONER JOE GARCIA
DATE:	**Monday, September 8, 1997**
TIME:	Commenced at 9:15 a.m.
PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	JOY KELLY CSR, RPR Chief, Bureau of Reporting H. RUTHE POTAMI, CSR, RPR Official Commission Reporters

APPEARANCES:

(As heretofore noted.)

I N D E X

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PROCEEDINGS

(Hearing reconvened at 9:15 a.m.)

(Transcript follows in sequence from Volume 18.)

CHAIRMAN JOHNSON: We're going to go on the record. Counselor, are there any preliminary matters before we entertain the oral arguments?

MS. BARONE: Staff doesn't have any. I don't know if any of the parties have any that they would like to bring up other than the oral argument.

CHAIRMAN JOHNSON: Mr. Horton, did you --

MR. HORTON: Madam Chairman, just to let you know when we left here Friday Mr. Falvey was due in last night, the ACSI witness, and I received a message over the weekend that he was not able to make his connections until this morning, so hopefully he's landing now. I don't think it's going to be a problem when we get to him, but just to let you know he may be a little bit late.

CHAIRMAN JOHNSON: Thank you very much. Any other preliminaries? Seeing none, then I guess we can proceed into the oral arguments. It's AT&T's motion?

MS. RULE: Well, this is a joint motion. It's on behalf of AT&T, MCI, Intermedia, FCCA, ACSI and WorldCom.

CHAIRMAN JOHNSON: And will you be conducting all of the argument?

MS. RULE: Unless somebody else wants to jump in.

CHAIRMAN JOHNSON: Okay.

MS. RULE: Thank you, Commissioners. You have in front of you a package of information, and the parties should also have copies by now. And what you have is an outline of Section 271, an outline of Section 252, an excerpt from the FCC's Ameritech order, specifically Paragraphs 110 and 114, and also a full length version of 271 and 252, and a longer excerpt from the Ameritech order. And lest the amount of material alarm you, I'm not going to talk about all of it. I'm just going to talk about the outlines.

We're asking you today to either strike BellSouth's draft SGAT or sever it for consideration in a separate proceeding. And this action is correct under federal law as well as state law.

First I'd like to take a moment -- actually it will take a few moments to explain why BellSouth's draft SGAT is irrelevant to this proceeding under federal law. And the purpose of your proceeding here is to allow the Commission to gather evidence in order to verify BellSouth's compliance with Section 271(c)

of the Telecommunications Act of 1996, and I think I've also heard it called lately the "Regulatory Attorney's Full Employment Relief Act."

This means that your job here today, and the entire proceeding, is a prelude to BellSouth's eventual application to the FCC under Section 271. So we need to look to the Act to determine whether, and to what extent, BellSouth can rely on a SGAT to show compliance with 271 requirements.

And as I mentioned, you have before you several pieces of paper that I've handed out. And the first one I'd like you to look at is an outline of Section 271. I find it much easier to understand things I can see rather than things I can only hear, so I wanted to show you the provisions that are before you today, and those that are not.

And I apologize in advance for the amount of time it might take to go through this with you. But your understanding of this section is essential to your decision in the case and it will also give you framework both for evaluating our motion today and BellSouth's response, as well as your eventual decision in November.

And the issue of your understanding of 271 is vitally important to this case whether or not you

decide to grant our motion.

The requirements for interLATA approval are found in (c) of 271. And if you take a look at the first page of the outline, you'll see that the paragraphs are successively indented. That's intended to show you what the structure is of the section, and that was I think paragraphs are less likely to be taken out of context. I think one thing we've seen over the course of your experience, and the FCC's experience, with Section 271 is it's very easy to take paragraphs out of context.

Your role is to verify BellSouth's compliance with 271(c) and that's the section with the box around it in the outline.

Paragraph 1 says that BellSouth can meet the requirements of 271 if it meets the requirements of either Subparagraph A, and that's Track A, or Subparagraph B which is Track B; and that's in the disjunctive; they get one choice here. Subparagraph A lists the requirements for a Track A proceeding. And as you know BellSouth has testified that this is a proceeding under Track A so this is the section that applies to BellSouth.

Track A is the correct track in this case because BellSouth has entered into one or more binding

interconnection agreements that you've already approved under Section 252 of the Act. BellSouth also says it meets the other requirements of Track A and you'll have to decide whether or not they do when it comes time to vote. And you'll see in the right-hand margin I've listed the issues next to the sections of the Act to which they apply.

Now, BellSouth testified that it's not proceeding under Track B. And a Bell operating company can only meet the requirements of Track B if no provider has requested interconnection and access, and if the company had an SGAT approved, or permitted to take effect under Section 252 of the Act. And again I've listed those issues in the margin next to Track B.

As you can clearly see from the structure of the Act, the SGAT is applicable only to a Track B case and BellSouth has assured you that this is not a Track B case.

Now, this isn't the only reference to the SGAT in Section 271. And if you take a look down at Subparagraph 2 which comes next, it again emphasizes the difference between Track A and Track B. And it states that a BOC, Bell operating company, meets the requirements of this paragraph, Paragraph 2, if one of

two things occurs: it's either providing access and interconnection pursuant to a Track A-type agreement, that is a 252 arbitrated or agreed upon interconnection agreement, or it's generally offering access pursuant to a statement described in Track B.

So this paragraph again makes its clear that Track A requires interconnection agreements, not a SGAT; and Track B requires a SGAT, not interconnection agreements.

In its motion BellSouth -- I'm sorry, in its response to our motion BellSouth states that Section 271(c)(2), the provision we just looked at, does not set out one method to meet the checklist if Track A is followed and a second if Track B is followed. If you look at Section 271, however, this simply does not support BellSouth's argument.

Section 271(c)(2), the paragraph we just looked at, does not allow use of a SGAT under Track A. The rest of Paragraph C sets forth the terms of the competitive checklist, and those are Issues 2 to 15 in this docket, and I haven't listed them on the outline. Whether the company is proceeding under Track A or Track B, it has to meet the requirements of the competitive checklist through whatever its chosen entry vehicle is.

BellSouth argues that it may rely on access and interconnection either provided or generally offered to meet the checklist. But that language is taken out of context. You find it only in subparagraph 2(B); that is you find it only in the competitive checklist. And as we've seen the checklist applies equally to both Track A and Track B, so, of course, you're going to see both options offered there.

Continuing on to Page 2 of the outline you can see Subsection D. This subsection requires the FCC to consult with you. And the reason for the consultation is to verify the compliance of the Bell operating company with the requirements of (c). So again your role is under (c); to determine their compliance with that paragraph. It then states the circumstances under which the FCC may approve a 271 application. And it again makes it clear that Track A requires interconnection agreements while Track B requires a SGAT, and that's found in (3).

According to this paragraph, before the FCC can approve a 271 application, it's got to find either that the company has met the requirements of subsection (c)(1), that is either Track A or Track B, and must find either that the interconnection provided

pursuant to Track A implements the competitive checklist, or that the interconnection generally offered pursuant to a SGAT offers all of the items in the checklist. And these two items are separate and distinct. You provide interconnection under Track B. You generally offer access under an SGAT. I'm sorry, I just messed that up. You provide under Track A; you generally offer under an SGAT in Track B.

And this paragraph, (3), again makes it clear that interconnection agreements are relevant to Track A and SGATs are relevant to Track B. And again, this is not a Track B case. That's what BellSouth has told you.

The FCC recently interpreted this provision in its Ameritech order. And I'd like to direct your attention next to Paragraph 110 of the Ameritech order. And you've got that in front of you.

There the FCC concluded that an offer to provide a checklist item pursuant to an SGAT does not fulfill the requirements of Track A. You can see this in the highlighted material. The mere fact that a BOC has offered to provide checklist items will not suffice for a BOC petitioning for entry under Track A to establish compliance. To be providing a checklist item a BOC must have a concrete and specific legal

obligation to furnish the item upon request pursuant to state-approved interconnection agreements.

This means that a Track A applicant must live and die by the terms of its interconnection agreements. An SGAT is simply inapplicable to determine checklist compliance for a Track A case. Again, BellSouth says this is a Track A case.

A few paragraphs later in Paragraph 114 the FCC again makes it clear that a Track A applicant must provide the interconnection pursuant to agreements, while a Track B applicant may generally offer interconnection pursuant to a SGAT.

If you take a look at the highlighted material on Paragraph 114 they very bottom it says "We conclude that Congress used the terms 'provide' and 'generally offer' to distinguish between two methods of entry."

Commissioners, the FCC has made it clear that Track A applicants must live and die by their interconnection agreements. This means that BellSouth must be able to show that it is either furnishing an item, or if no competitor is actually using the checklist item, that BellSouth can furnish the item upon request pursuant to a state-approved interconnection agreement, not pursuant to a SGAT.

BellSouth argues to you that it's not this Commission's call to determine whether it may proceed under Track A or Track B. And I happen to agree with that. BellSouth also argues that it's not the role of this Commission to decide whether it may rely on an SGAT in a Track A proceeding. I'm not so sure I agree with that one. In any event, you're not called upon to make either of those two determinations.

BellSouth has already testified to you that it's proceeding under Track A and not Track B. And the FCC has stated that Track A requires provision of service under interconnection agreements, not an SGAT. Of course, you are certainly free to disagree or agree with the FCC. And, indeed, you'll be called upon to offer your consultation to that agency. But the FCC is the agency that ultimately will determine the success or failure of BellSouth's 271 case, and the FCC has explained how it interprets the requirements of Section 271.

The interpretation is well within its jurisdiction, and according to the FCC, an SGAT simply has no place in a Track A proceeding.

Now I'd like to switch gears and talk to you about the reasons you should dismiss the SGAT or sever it for consideration in another proceeding under

Florida law. And given the amount of time I've asked you to spend on Section 271 I'll try to keep this one a little shorter.

In our motion we've set forth several reasons why you should dismiss or sever the SGAT. First of all, it's a draft. And as you can see from Section 271(c)(1)(B), there's no legal significance at all to a draft of a SGAT. It's not recognized under 271.

Next, the current draft was filed or revised after the close of all of the discovery in this case. That's reason enough to consider that that version should not be determined in this case. And we still haven't seen an SGAT as of today, although you heard the testimony that BellSouth intended to file it last week.

Additionally, BellSouth has proposed no issue specific to approval of an SGAT. Issue (1)(B)(b), which is in the Prehearing Order, incorporates none of the substantive requirements of Section 252(f) and that's the section of the Act that sets the standards for your approval of an SGAT.

BellSouth should have completed this SGAT process well before it filed this petition. In Order No. PSC 97-0703 Chairman Johnson directed BellSouth to

file with its original petition all of the evidence it relies upon to demonstrate that the checklist had been met as of the time of filing. You've heard testimony that BellSouth hasn't met it; even if the SGAT were somehow applicable, there is no SGAT today. This isn't just an academic issue and it's not just legal posturing as BellSouth suggests in its reponse to the joint motion.

I'd like you to take a look at section 252(f), and that's the one-page document in front of you.

Your role is shown under 252(f)(2), entitled "State commission review." In order to approve an SGAT you must specifically find that it complies with Section 252(d) and the implementing regulations for that section. That section requires nondiscriminatory cost-based prices. There's no issue in this case regarding prices. And you've heard testimony that there are no cost studies either. And even though there are some arbitrated prices in the SGAT, nobody except the parties to those arbitrations had the ability to challenge those prices because they were excluded as intervenors.

Under 252(d) you must also find that the SGAT complies with 251(f) and its implementing

regulations. That section defines duties of interconnection, unbundled access and resale among other things. There's no issue in this case incorporating those standards.

And finally, you may establish or enforce other requirements of state law when reviewing the SGAT, including compliance with state quality standards. There's no issue in this case regarding those requirements either.

I want you to be very clear what you're doing when you approve an SGAT. You're setting rates. That's a ratemaking proceeding. You're establishing the terms and conditions of interconnection. You're determining what services are going to be available to interconnecters without lengthy and expensive negotiation, and you're also determining what services will not be available. And most importantly, you're allowing BellSouth to impose those rates, terms and conditions on companies who are not represented in this docket.

I'd like to hand out a copy of the FAW notice. It was issued in this docket and it doesn't meet the notice requirements of the APA for an SGAT approval docket.

Commissioners, there's nothing in that

notice that places the public on notice that the Commission will be setting rates in this proceeding. There's nothing in it that places the public on notice that the Commission will be setting the terms and conditions under which ALECs may interconnect with BellSouth. And there's nothing that places the public on notice that this is their clear point of entry into the agency's action under section 252(f). This notice is simply insufficient under Chapter 120 to allow the Commission to engage in those actions, which is exactly what it would do if it approved an SGAT in this docket.

Now, why isn't that information here? It's not here because that's not the purpose of this docket. This docket was opened well over a year ago as a docket to consider BellSouth's entry into interLATA services pursuant to 271. And that's what the title of this docket says, that's what the public is entitled to believe will happen in this docket, but that's not what BellSouth wants you to do.

I'd like you to keep in mind that BellSouth and BellSouth alone has the keys to this case in its pocket. BellSouth alone has been in a position to determine how and when to file this case. The parties couldn't do it. We've had a difficult enough time

just figuring out what Bell intends to do and when it intends to do it. And we're certainly not required to guess.

If you take a look in the petition in this case, the petition doesn't even reveal whether BellSouth intends to proceed under Track A or Track B despite the clear instructions in the procedural order that BellSouth should do so. Until depositions were held in August, over a month after BellSouth filed its case, BellSouth wouldn't even state whether it intended to proceed under Track A or Track B, and you, yourselves, heard last week how difficult it was to extract a coherent explanation of why BellSouth thinks it meets the requirements of 271, and we still don't know when they plan to file the SGAT.

You've heard an argument from BellSouth that the SGAT is for the little guys. Where are they? They are not in this proceeding. Everybody here has an interconnection agreement, has BellSouth has pointed out. The little guys didn't get effective notice. They are entitled to notice and they are entitled to a clear point of entry under the APA.

I'd like you to take the time to read Sections 252 and 271 carefully. I'd like you to look at the issues in this docket. Those issues simply are

not sufficient for approving an SGAT under Section 252. Take a careful look at the FAW notice. It's not legally sufficient under Chapter 120 to allow you to do what BellSouth wants you to do.

You have independent grounds under federal law and state law to dismiss this SGAT from this proceeding. It doesn't mean BellSouth can't have an SGAT and it doesn't mean they can't have a separate proceeding, but this is not the time and place to do it. We urge you to dismiss the SGAT, or at the very least, sever it for consideration in a properly noticed proceeding. Thank you.

CHAIRMAN JOHNSON: Thank you. Any questions, Commissioners? Then we'll proceed into BellSouth's response.

MR. CARVER: Thank you, Chairman Johnson.

There are really three things that need to be looked at I think for purposes of deciding this motion. The first is the question of substantively whether the SGAT relates to Track A and B. The second is procedurally whether there's any problem with it being in the case. And the third are the positive reasons why it should be here. In other words, the utility of the SGAT.

And I think the third aspect is probably the

one that's the least controversial and the most simply expressed, so I'm going to begin with that.

This case should really be about substance and not about form. The issue here before the Commission is whether BellSouth has made offerings that are sufficient to be the checklist, whether they comply with 271 and whether we provided to the parties -- and by the "parties" I mean the parties here and other new entrants -- the tools to enter the market. What's really important is the substance of the offerings and the decisions that you make about them into your consultative role. What's much, much less important is the source that you look to see what those offerings are. And that's really what this entire argument is about.

Because there are approximately 50 interconnection agreements out there. Some of these agreements meet the checklist on particular items; some of them exceed the checklist, some of them fall short of the checklist. But if you put them together there are numerous agreements that meet every checklist item. However, it's a fairly complicated process to go through those and mix and match and try to find out which one goes where. And for that reason -- well, let me back up and first of all say

the SGAT, however, is the only place where there is one unified statement of precisely what BellSouth is offering that we believe meets the checklist. So it's the easiest and simplest place to look to find out what we're offering and what we believe complies. And, again, as I said, it's not that they are not in the interconnection agreements, it's just the interconnection agreements are much, much more difficult to follow.

So what we're really talking about here is what is the most convenient source to look to to gather this information. And I think the fact that the SGAT is the best source and most convenient source is proven by the testimony of their own witness last Friday. You heard Mr. Gillan talk about his view on three of the 14 checklist items, and obviously BellSouth disagrees with the substance, but you heard him say that for purposes of putting together his testimony he reviewed the SGAT. He also reviewed Commission orders and he reviewed the testimony, but he focused on the SGAT. He didn't focus on the orders, and, in fact, he didn't seem to have a very good knowledge of what was in the AT&T or MCI order.

And I point that out only because I think that's a vivid example of the fact that the SGAT has a

tremendous use in this case, and that's to set forth very succinctly what needs to be viewed.

CHAIRMAN JOHNSON: Let me interrupt just one minute to make sure I'm following you here.

With respect to the SGAT then, you are -- it's Bell's position that all of the items that are listed in the SGAT are actually taken from negotiated agreements or interconnection agreements that are actually filed. This isn't information in the abstract; it is actually applied information.

MR. CARVER: It's applied information. Now, to clarify, there may be some instances where we've taken something directly from a Commission Order. And I can't say that every aspect of every Commission Order has been incorporated in an agreement somewhere, so in some instances we have rulings of this Commission.

But the basis of the SGAT are the agreements. And I believe if we were forced to go through the agreements and to restructure our testimony, and to point to you where those agreements are that a checklist compliant, we could do that. We have structured the case the way we have simply because it's a lot more efficient to say "Here's the SGAT; here's what meets the requirements." Rather

than to say, "Here are 50 agreements and some meet them and some don't," and they are all over the board.

But in answer to your question, yes, the SGAT is based on the agreements. That's why I said to begin with I think this argument is essentially one of form over substance because the real issue here is what BellSouth is offering.

CHAIRMAN JOHNSON: So as it relates to Ms. Rule's argument, one are her procedural arguments that this needs to be taken up in a full blown hearing because we're setting rates and establishing terms and conditions that we've not previously considered, Bell's response is what?

MR. CARVER: I don't think you're setting rates in the way that she represents. I think basically you're acting pursuant to the Act, which says that the SGAT is to be filed and within 60 days it can be approved. Now, in this case, of course, we filed the draft SGAT to in effect extend the time period to 120 days. But we've made no secret of what we're doing. We've made no secret of the fact that -- or approval of something that we're seeking here. And I think the issue before you on the SGAT approval or not is exactly the same as 271 issue, because you're going to have to look for 271 purposes to see if our

offerings are checklist compliant. And the standard for approval of the SGAT is whether it is checklist compliant. So the issues are precisely the same.

As to her notice argument, I don't think that either the issues or in the notices that there's any procedural infirmity here. I think anyone who wanted to intervene had adequate notice of what was going on here that they could have done so.

I'm not sure -- I hesitate to make technical arguments but I'm not sure that AT&T really has standing to speak for as they call them, "the little guys." All of the parties that are here are here. I don't know that anyone else has really been deprived of an opportunity to appear. I will say that the way that we restructured this case, which is to have the SGAT approval and 271 approval in the same case has been we've done it this way in six states. Many of these parties have been involved in those cases. None of them have complained before. And since we did the first 271 hearing, which I believe again last January, no one in any state has gone forward and complained that they were deprived of an opportunity to participate, or that there was some mystery to them as to what was going on.

So, again, from a procedural standpoint, or

at least that piece of the procedural argument, and certainly from the utility's standpoint, the SGAT belongs in the case.

COMMISSIONER KIESLING: Go ahead. I had a question, too, along the same lines.

CHAIRMAN JOHNSON: Okay. The final question then -- Ms. Rule cited to 110 of the Ameritech order where the FCC concluded -- they kind of defind or clarified the definition of "provides" and I get Ameritech agreed with them, that "provides" means a check -- "We conclude that a BOC 'provides' a checklist item if it actually furnishes the item at rates and terms and conditions that comply with the Act." But I guess the operative thing is that they are actually providing and not just offering.

I'm understanding you to say that your SGAT is a composition of things that are being actually provided. Is thaqt correct.

MR. CARVER: That's correct. That's correct. And I think there's an independent question of whether a state-approved SGAT creates a concrete and legal binding obligation. I'd actually planned to address that a little bit later in my response but I think that's another line. But actually, I mean the point you raise is one that's very important, which is

to the extent the SGAT incorporates the agreements, it's simply a different expression of those agreements. If the agreements are binding, then to the extent the SGAT incorporates them, then obviously those same offerings would be required to be offered in exactly the same way. So it's a binding obligation, whether it is taken directly from the agreement or whether the SGAT incorporates the terms of the agreement. And, again, I do have some more I want to say about that but I'll save that for a little bit later, if I may.

CHAIRMAN JOHNSON: Commissioner Kiesling.

COMMISSIONER KIESLING: I'm just a little bit confused on the draft SGAT. If everything in it is based on either negotiated or arbitrated existing interconnection agreements, how do you square that with the 252(f) language that requires that it -- they be cost based? Do you have cost studies on all of those, or did you pull them out of interconnection agreements?

MR. CARVER: For the most part we pulled them out of either interconnection agreements, and I believe arbitrated interconnection agreements. To address the cost based issue more generally, I think there's sort of a subtext here, which is that the

parties filed this motion don't agree that the rates that the Commission have set are cost based. They have argued in the other states for TELRIC studies. But what we have here is arbitrations with MCI, with AT&T, and with MFS in which rates were set. We took those rates and we put them into the agreement, both the permanent and interim one. Now there may be some instances in which there are a few rates that were not specifically arbitrated. And as I sit here now I cannot give you every rate that would apply to, but I believe there are comes studies to support those.

But in the main, the rates that are in the SGATs are the rates that have been seet by this Commission in the arbitrated proceedings, and the standard that was applied was, of course, that they be calls based. So I think any argument they make that they are not cost based is, in effect, I suppose some sort of a request for reconsideration of the Commission's order, because that is, in fact, where they came from.

COMMISSIONER CLARK: What I'm trying to figure out, though, is that if this Commission is required to approve the statement, what's the proceeding, and where is the proceeding in which we are going to examine each element of your draft SGAT

and look at your cost based -- your cost information and decide if each and every one of those is based on nondiscriminatory cost based studies?

MR. CARVER: Again, I think that's been done already because the rates, for the most part, are preapproved rates from the arbitration.

COMMISSIONER KIESLING: See, that's my problem. You keep saying "for the most part." Until someone points out to me -- goes through your SGAT and says "This rate is based on this arbitration and this was the cost data that supported that rate," et cetera, all the way down through the whole thing, there are some that are not based on any arbitrated agreement.

MR. CARVER: That's true. And to be perfectly candid with you as I sit here I can't tell you which are which. What I can do is I can provide for the Commission a list. It may take us a day or so to do that, but I can have someone go through the SGAT and provide you with a reference for every price that's in the entire document if that would be helpful.

COMMISSIONER DEASON: Mr. Carver, I have a couple of questions. Is it your position that the arbitrated agreements taken as a whole prove that you

are in compliance with all of the requirements to get approval under 271 to enter into in-region interLATA service?

MR. CARVER: Yes, sir, that is our position.

COMMISSIONER DEASON: Okay. Is it your position legally that you can take aspects of different agreements and show that taken as a whole that you meet the requirements. It doesn't have to be one agreement that meets everything. You can take this section of this agreement and this section of another agreement, mix and match, so to speak, and meet the requirements.

MR. CARVER: Yes, sir, I believe we could do that. And it would be a much more difficult to follow process and it would be a lot harder to get to the core issue of what BellSouth is offering and the substance of our offerings. But to give you direct answer, yes, I think we could do that.

COMMISSIONER DEASON: So you're saying as a matter of convenience you filed an SGAT in this proceeding to help demonstrate what can already be demonstrated under the various interconnection and arbitrated agreements.

MR. CARVER: Yes, sir. That's our position.

COMMISSIONER DEASON: Let me ask you another

question then. Why did you choose to seek approval of the SGAT in this proceeding as opposed to filing the SGAT while we were going through the arbitrations and everything else and saying, "We want approval of this because at some point we may need it, and we'll just treat it on its own merits, and we'll deal with it." And then if it got approved, fine, you could have included it in this proceeding. If I wasn't approved, well then you knew basically you had to use the interconnection agreements themselves.

MR. CARVER: I think what we were trying to do is to make the SGAT offering as consistent as we could with what came out of the arbitration. So for that reason -- first of all let me say, we could have done it the way you suggested. I'm not saying we couldn't have. But what we wanted to do was to make the offerings as consistent as possible with what had been arbitrated. So, for example, when we had a dispute with AT&T, or MCI, or whoever about what was required by the Act on a particular point and we submitted that to arbitration. When we had a decision we had something we believed was consistent with what this Commission would approve. So after that process was complete, then we put together the SGAT to reflect the rulings of this Commission.

Now, in terms of why we didn't do it the other way, again, I can't give you a definitive answer. I will tell you that we've done this in nine states and we've followed this procedure consistently.

COMMISSIONER DEASON: But you are asking us to do two things in the proceeding: Is to approve the SGAT and then say that it meets all of the checklist items, and, therefore, make a recommendation to the FCC that you should be granted authority.

MR. CARVER: Yes, sir, we are. And the standard is exactly the same. I believe that if the -- I should put it this way, that if the SGAT's terms, which are taken from the agreements, are checklist compliant, then it should be approved. I mean the Act doesn't really get into specific criteria outside of the checklist that would militate in favor of approving it or disapproving it.

So when you approve the SGAT, what you're really doing is finding it to be, in effect, checklist compliant. And that we believe is another reason why it's efficient. It's something that would conserve the resources of the Commission to do both at the same time because the standard is precisely the same. If we were to split it out, in effect we would go through the SGAT once and argue it was or wasn't compliant,

and then have a whole separate proceeding to argue, in essense, the same issue all over again. And since the standard is precisely the same, it really makes a lot more sense to do it once.

Again, I don't believe that any party is surprised that we've intended to do this, and I don't believe anyone has been prejudiced by doing it this way.

COMMISSIONER KIESLING: Then that brought up another question for me. Can you tell me, since I looked at all of this stuff and I've read it, I think, pretty carefully, where in your petition or where in the issues it is identified that you are asking us to approve this SGAT. And there's an issue stated in here that relates to the approval of the SGAT?

MR. CARVER: Well, the one -- well, the issue that raises it directly would be Issue 1B and the language of that is whether a Statement of General Available Terms and Conditions has been approved or allowed to take effect. And the position that we filed in our prehearing statement was no, it hasn't been approved yet, but it has been submitted for approval in this proceeding. And our belief at the time we agreed to include this issue was that that properly raised the SGAT.

Now, I know that a number of other parties have argued that it didn't properly raise that issue but the fact is this issue has been as it has for a year and there are perhaps some subissues that need to be considered in order to make the determination encompassed by 1B, we believe it is adequate. I think frequently there are issues in cases that are fairly broad and parties argue under the broad umbrella the issue. And I would only say that if any of the other parties this didn't adequately address the issue, then they had a year to ask that the issue be changed. Because everyone acquiesced to this issue. Everyone agreed for it to be in the case. And if the parties that opposed BellSouth's application think that this should have been more detailed or it should have said something else, then they had more than ample opportunity to raise that and they didn't do so.

Turning back to the other points that I wanted to make, there are two other aspects here: the substantive aspect and the procedural. And in terms of substance, I really don't believe you need to spend too much time focusing on this because, in effect, the movants have conceded that substantively this relates to Track B, and they've conceded that Track B could well be the basis upon which we file at the FCC. And

that's found in their motion at Page 2, and I'll just read it to you because it's only a couple of sentences. Four lines into Page 2, they state that "On July 15th, 1997, the Commission determined that its role is limited to the consultation with the FCC, and thus it cannot prohibit BellSouth that pursuing Track B access to interLATA authority. "Then in the next paragraph they state as shown below, "And SGAT is irrelevant to Track A and procedurely inappropriate for consideration under Track B."

So the argument as originally posed in the motion, which I believe is the argument they are still traveling under, is that the SGAT does not relate to Track A, but they have, in effect, conceded that it relates to Track B and they've conceded that Track B may well be the basis for what we filed with the FCC, although admitted BellSouth believes we're Track A compliant. So, from a substantive standpoint it belongs in the case.

A lot of the argument that addresses Track A and whether it relates to Track A is something that doesn't need to be reached for purposes of your decision. I do want to focus on that, though, because I think it's an important part in the case in general.

COMMISSIONER DEASON: Let me interrupt for

just a second. You've indicated to me -- and I'm not trying to put words in your mouth, so if I'm wrong correct me -- but you've indicated to me that you've included the SGAT in this proceeding for a number of reasons, not the least of which is expediency and trying to simplify things; to make it easier to review the substance of your filing. Is that basically right?

MR. CARVER: Yes, sir, that's correct.

COMMISSIONER DEASON: Okay. Well, for the reasons of simplicity and expediency, wouldn't it have been better if you had come to this Commission and said, "Commission, we're filing under Track A." Or, "Commission, we're filing under Track B." One or the other. And let us concentrate on that and see if that's the requirement that you meet, make our recommendation to the FCC on that basis. Why is it that we have both in front of us? Why is it necessary that we have both in front of us? If you're so concerned about expediency and simplicity.

MR. CARVER: I think ultimately the decision is going to have to be made at the FCC on the basis of what we file with them at that time. And for that reason we want to preserve the option of filing both because obviously we're getting FCC orders on an

almost weekly basis that have different requirements and we'd like to keep that option open. For that reason we have been hesitant to rule out either track.

Now, at this point I think we've said pretty clearly we believe it's Track A, but there are ways that Track B could be reached and they could be reached on the basis of determinations by this Commission. So we want to keep that option open. Let me give you one example. This is by no means an exhaustive list, but this is just one example.

In the SBC ruling the FCC said that in order for a request for interconnection to meet Track A, that is, to put a party on Track A it has to be a qualifying request. Then they went on to say that not all requests are qualifying requests. Someone may request interconnection and use the interconnection in a way that even once they implemented it, and there was no question about implementation, it might very well not satisfy Track A. And basically also -- and there are several reasons; they might not serve residential customers, they might not serve business customers, it might not provide discriminatory access. What they ask might not be adequate. So it suggested that at the time the application is filed they are going to scrutinize, to some extent, the request for

interconnection and determine whether they are qualifying or nonqualifying. Now, in this case we have had a lot --

COMMISSIONER DEASON: Are you saying it may not qualify by actions of the person who he is seeking interconnection even though the agreement specifies all of the nondiscriminatory that is applicable to residential business, all of those things, it's actions of the person seek the interconnection; if they fail, that causes you to fail?

MR. CARVER: I think that's a possibility. Now, I think given the recent ruling in Ameritech that's a little bit less likely. I'm going to have to get into that discussion in a moment because of the discussion about what it means to provide, and the fact that if you generally offer something, that's good enough. But up until that decision came out, the FCC seemed to be saying -- and certainly the parties adverse to BellSouth were arguing -- that someone had to actually be using it. And that was the real problem.

What we still have is we have a situation where Track A requires service to both residential and business customers. So, for example, we could have a situation where let's say Company X comes to us and

they enter inot an interconnection agreement and it meets all 14 of the checklist items, and it's fully compliant and there's no question about that whatsoever. If they only use that to serve business customers and they don't serve any residential customers at all whatsoever, then arguably Track A hasn't been met because you have to have people served both ways. So there's still an issue of the conduct of the people who are interconnecting and what they do.

And, again, we believe we meet Track A. But there are a lot of vagaries at this point; there are a lot of fact issues floating around and it's difficult to know who hasn't entered the market for business reasons; who hasn't entered the market because they don't think the timing is right, or who hasn't entered the market for some other reason. So, for that reason we don't want to foreclose the option of going Track B, although I hope I've said as clearly as I can that we think Track A is more appropriate for us. Technically we believe B should be left open because of all the vagaries of the facts and the way they continue to come out. The fact the FCC standard seems to change quite a bit.

So Track B, we believe, needs to be there,

and the SGAT inarguably relates to Track B. I don't think anyone has argued you can't use the SGAT for Track B. The only procedural issue -- I'm sorry, the only substantive issue, and, again, I don't think it's one you need to reach for purposes of this motion -- is whether the SGAT relates to Track A. And we believe it does for really two reasons. One is the actual language of the Act.

Now, you have been given an outline and I would suggest that rather than reading the outline it's more appropriate to read through the Act. And what you'll find is that there are two different provisions that are operative here, or two different sections. There's 271(c)(1) and there's 271(c)(2).

271(c)(1) sets forth Track A and Track B and it says that under these, interconnection and access is to be provided or generally made available. And then in the independent section, 271(c)(2), it also states the independent requirement is the access and interconnection that is either provided or made generally available has to meet the 14-point checklist.

Now, the argument has been made that Track A has to be shown in one way; Track B has to be shown in another way. And I simply believe that is

hypertechnical argument that doesn't really get to the fact as I said before what really needs to be focused upon is the substance of the offering.

Now, Track A can be satisfied through interconnection agreements, that those interconnection agreements should be consistent with the SGAT and we believe that ours are. And there's nothing wrong with looking at the SGAT to actually see what it offered and to look at it for the purposes of checklist compliance. And obviously we believe that that's appropriate under the Act, and that's what we're urging.

Now, the argument has been made that Ameritech interprets this provision otherwise, and I think the short answer to that is that the movants are misinterpreting Ameritech. Ameritech dealt with a narrow issue.

In that case Ameritech did not have a state-approved SGAT. So Ameritech and I believe Bell Atlantic came before the Commission and they argued that under Track A the word "provide" didn't have to mean only furnish; that it could mean furnish or it could mean make available. There were some other parties, and I know in one paragrpah AT&T is mentioned specifically, but there are other IXCs that came in

and said no, that's not correct. To provide something it has to be furnished. Simply making it available or offering it in any form is not enough.

But the narrow issues before them, which was raised by Ameritech, was if you have an agreement and if the agreement has been state-approved, and if the agreement has a term in it that makes an item available but no one buys it, can that still be compliant? And looking at that issue the FCC yes, that can be complaint.

Now, it went on in dictum to say that some other parties had urged that offers would be enough. And they said, well, no, offers generally aren't because the obligation has to be concrete and binding; it has to create a specific legal obligation. But what they never reached was the question of if you have a Statement of Generally Available Terms and Conditions that is unified, if it's presented to a state Commission, if it's approved and if that's submitted to the FCC, does that create a binding obligation? That question was never reached. And if you look at the paragraphs, both of the ones that have been excerpted, and if you look at the full text of the Ameritech order, I believe it begins about Paragraph 109, the words "state-approved SGATs,

state-approved statement, state-approved offering," those words don't appear anywhere in there because that simply wasn't the issue.

I would have to agree with the FCC that if someone was offering something in a way that was not formal or that was not binding or that was not state-approved, then there might be a legal problem enforcing that.

But what we believe is if you have an SGAT, particularly if you have an SGAT that is drawn from agreements that are binding -- but even apart from that, if you have an SGAT that is state-approved and that's the basis of your showing checklist compliance, and it comes through the state mechanism and the record is gathered and that's submitted to the FCC, then we believe that is adequate. And we believe that creates a binding obligation. But I'll have to say at the same time, that's never really been tested at the FCC. Because this particular case, and the issue before the FCC, was something different. So they haven't really replied on this one way or another. They said that a state-approved agreement is enough. As to whether a state-approved SGAT is enough, they haven't said anything one way or the other, but I would submit to you for all of the reasons I've talked

about, there really is no difference between the two. Again the substance of the offerings is what should control.

COMMISSIONER DEASON: If you're going to be relying on the fact, what you hope is that this Commission considers your SGAT and approves it, if you're going to be relying upon that as meeting the requirements, what about the argument that this proceeding has not been noticed for SGAT approval? In fact, there's not even the sufficient issues identified to adequately consider and give approval of a SGAT consistent with the requirements of the Act.

MR. CARVER: I think -- well, -- I think the issues could be read together.

First of all, I think issue (1)(B) is the one that raises the SGAT specifically. As you get beyond that, Issues 2 through, I believe, 15, look at each of the checklist items specifically. And in order to resolve Issues 2 through 15 you have to look at BellSouth's offerings. To the extent those offerings are embodied in the SGAT you have to review the SGAT.

So our position going into this and our view was that 2 through 15 was going to necessarily require a consideration of our offerings at whatever form:

through agreements or through SGATs. So what we have done is we have agreements on file, we have SGATs, and depending on how you rule on 2 through 15, that's going to determine whether the SGAT should be approved or not. If you find that on 2 through 15 our items are compliant, then the SGAT should be approved. If you find there are problems with any of those, then the SGAT could perhaps be approved in part but in the in whole. Those are the particular ones that raise the standard and allow you to focus on the particular provisions of SGAT.

The fact that the SGAT is part the case we believe is set for the by 1B, which is the question of whether this is an approved SGAT. And the position we've taken consistently, which is no, there's not, but we're requesting approval in the same proceeding. Again, it's simply a question of trying to do this as efficiently as possible. Because the same issues that relate to checklist compliance and the issues that relate to approval, those issues are the same. So that's why we've raised those here.

And I've said this before, but at the risk of repeating myself I'll just say I think all of the parties to this proceeding have known what the proceeding was going to be about for most of the year

that this has been going on. There were a lot of filings, as long as two, four and six months ago asking us to declare what we were going to do and asking us to come forward. And I think that everyone understood that the SGAT was going to be a part of this. And I think that if anyone believed that particular subissues and particular things needed to be consider, and (1)(B) as inadequate to do so, then the appropriate action would have been for some of these joint movants to say that at some point; and to say that there was something else they wanted to have testimony about or something they wanted to argue, and that it wasn't adequately encompassed in (1)(B) because 1(B) wasn't broad enough. But no one did that. We didn't do that because we believe (1)(B) is adequate. The other parties didn't do it and I'm not quite sure why but they didn't.

So I believe that that umbrella issue, which has been there a year, and during that year we've traveled under the assumption it was adequate is what states that the SGAT is there.

COMMISSIONER DEASON: You would agree that the wording of of Issue (1)(B), Section B, is has there been an SGAT approved; not should there be an SGAT approved, or the filed SGAT, should that be

approved? It's a very simple factual issue: Has there been one approved? And I think everybody could stipulate no, there has not been one approved.

MR. CARVER: No, there hasn't been. And part of the problem here candidly is the timing of the case. I mean the docket opened a year ago and year ago, frankly, we didn't know what we were going to file. I don't think anyone knew then how the case was going to travel. But the issues were set back then because discovery began; I think probably everyone anticipated we were going to file earlier than we did. So the case opened, discovery began, we needed issues; they were framed a year ago; the parties did a great deal of discovery and the case moved along quite a bit. So by the time we got to the actual filing of our testimony it had been there for quite a time.

Now, at that point, based on what happened during the past year, perhaps the issue could have been reworded, and perhaps it could have been reworded more artfully. But I assume what would have happened if we had asked in June or July to reword the issue is that parties would have objected. Because at one point, in fact, we did on a different issue, I believe it was public interest, request the addition of an issue there, and what we heard from parties was their

objections because they said the issues have been as they have been for a year and they shouldn't be changed now. We should leave them the way they are.

So I think the assumption we made is that the substance of what we're arguing is here. And given the fact that the issues have been framed for a long time, and that obviously parties are opposed to their being changed, there's not a lot of use in trying to reword that so that it would more artfully raise what we were trying to raise here.

But I think the fact remains that everyone knew for some time now, certainly since the beginning of July, that SGAT approval was one of the issues that we were presenting. So I think to move to the substance of what's occurred, I don't think anyone can say that they have been surprised by this; I don't think anyone can say that they have been prejudiced by this. And again, I think what is being made about the (1)(B) issue is really a technical argument. While I certainly will concede (1)(B) could be more artfully framed, under the circumstances I think why it came out this way is understandable, and I think why it came this way -- I think the way it is is enough to allow the parties to argue what they need to.

As to the other procedural aspects, the

draft SGAT issue I think, once again, it's form over substance. The SGAT requirement is that it be filed 60 days before approval. And what we tried to do is to begin at the time roughly that we anticipate a vote, back up from that and file the SGAT 60 days from then. And based on that, the SGAT should be filed any day. I can get the precise date for you if you'd like, but it should be filed, if not today, then within the next couple of days.

What we did with the draft SGAT was to try to take the precise language that will appear in the agreement and put in a draft form and file it with your testimony. Because in doing that we, in effect, gave the Commission an extra couple of months or so to review our offerings in order to make determinations about them.

I think extending that review period is a positive thing. I understand that it's given rise to an argument technically it's not an SGAT, it's a draft SGAT. But again, what we've done in state after state is to file exactly the same thing as the official SGAT that's in the draft SGAT, and I think the parties would agree that's been their experience, and within a day or two you can certainly see that it's doing the same here.

Finally, I will say that there was one revision and the revision was not made not too long ago -- actually about a week before the hearing began. That was occasioned by the Eight Circuit decision. Had it not been for that, there would have been no revisions at all.

One argument I think that was made in the motion, and it was made a little bit last week, but they de-emphasized today, was the argument that they were somehow surprised or did not have a opportunity to prepare to address the revisions. And in that I would say two things. First of all, Mr. Scheye gave his deposition on the 15th of August, and in that deposition, on Page 58, he was specifically asked whether there would be revisions of the SGAT? And he specifically said yes, there would be minor ones to bring it into line with the Eight Circuit. Now, after that there's discussions off and on throughout the remainder of the deposition and it's clear that Mr. Scheye doesn't have complete knowledge and he doesn't know about all of the changes, but he at least tells them that there will be some. That was more than a week from the end of the discovery period. And given that the parties have not been bashful about requesting discovery from BellSouth, I assume that if

someone really wanted to know about it, then we would have had a request for a deposition.

That aside, the changes, the revisions to the SGAT, there were only five of them. One was to simply change the letter that was used to identify an attachment. They were all fairly brief. In fact, the document that summarize them was only about two pages long, and then there was a red line version attached. The parties have conducted extensive cross examination on this, and they have, in fact, obtained leave to conduct more if they need to. So I don't think that anyone could argue they have been surprised or prejudiced.

In closing I just want to say -- I keep going back to word "prejudice" because that really is the standard. Under Rule 1.270 of the Florida Rules of Civil Procedure, severances are to be done when it determine -- it refers to a court, but in this case when the Commission determines that it is appropriate for convenience or to avoid prejudice. And I think what has been noticeably absent from their entire argument is any indication that any of the six moving parties have been prejudiced by this.

The fact is they knew what was in the case, they've had ample opportunity to prepare for the case

and there's been no prejudice whatsoever. Thank you.

MS. RULE: Thank you. A couple of things, Commissioners.

First of all, BellSouth has the opportunity under federal law to waive that 60-day clock. That's simply just not an important issue here.

It appears that Mr. Carver's argument boils down to this: We should have known what they were going to do.

You've heard the testimony. You know how hard it was to figure out what they're going to do when they are telling what they are going to do. We're not required to guess in advance and propose every issue that might allow BellSouth to come up with some alternate entry approach. That's their job and they simply didn't do it.

I'd also like to point out to you that Chairman Johnson issued a procedural order on July 2nd. That was certainly pretty late in the game but there were new issues added at that time. BellSouth had every opportunity to throw in its new issues then.

With regard to the arbitration provisions in the SGAT, I have a couple of questions on that. First of all, how has BellSouth condensed 50 interconnection agreements into its SGAT? There's no testimony on

that. Mr. Carver is basically testifying to you that that's what they did, but that's not what we heard from the stand. We just don't know and it's not been tested.

Mr. Scheye did testify that some of the costs or prices proposed in this proceeding have not been subjected to any arbitration proceeding. He also testified that there are no cost support documents in this proceeding.

With regard to the costs that have not been arbitrated, I don't believe you can make a decision to approve them. There's no evidence.

With regard to those costs that were approved in arbitrated proceedings, I'd like to remind you that those proceedings were limited to the parties. For example, the FCCA tried to intervene and was told that was not appropriate. That those arbitration proceedings were limited to the parties. You certainly can't accept any cost in a arbitration proceeding as being applicable to everybody. You specifically said you were going to be doing that on a case-by-case basis.

Finally, with regard to the costs I'd like to point out to you that the only interconnection agreements that can meet the 252 standard are

arbitrated agreements; not negotiated agreements. Take a look carefully at that material I gave you. BellSouth is relying on a lot of agreements here. A lot of them are not arbitrated, therefore, they can't rely on those costs.

Again, you don't have any testimony where this all comes from. You're being asked to rely on BellSouth's assertion that everybody should have known and we all had the opportunity to inquire. But I'd submit to you that's not the notice requirement in the state of Florida.

COMMISSIONER CLARK: Ms. Rule, let me ask you something. What is the standard we should follow on a Motion to Strike?

MS. RULE: That's a good question. I don't have an answer.

COMMISSIONER CLARK: Okay.

MS. RULE: So I suggest you just sever it instead.

COMMISSIONER CLARK: I'm sorry, then the motion to sever, you disagree with what --

MS. RULE: I guess here's my basic position: You don't have any evidence before you that allows you to make the sort of determination requested by BellSouth. The notice in this docket is insufficient

to allow you to approve the costs requested by BellSouth. I don't think it's a question of the standard to be applied; I just don't think you have -- you have issued the legal notice to allow you to do that. I don't think it's Staff's fault --

COMMISSIONER CLARK: So is it appropriate to sever it as opposed to dealing with it straight on as to whether or not you have had adequate notice?

MS. RULE: I don't think the question is whether AT&T has had adequate notice. And I'd like to respond to Mr. Carver's point that AT&T and others may not have standing. Well, only parties with interconnection agreements are the ones here. And if none of us have standing, then who is here to challenge the SGAT? Nobody. Nobody got any notice.

I think if you sever this proceeding you can still continue on with BellSouth's SGAT, if indeed they pursue it. Strike it, sever it; really it's all the same for for purposes of this proceeding. It's not been properly noticed and this isn't the time or place to do it.

You know, when I was in law school, and I imagine a lot of other people heard this, they always told us argue the law. And if you don't have the law on your side, then argue the facts. And if you don't

argue the facts on your side, then you better argue fairness.

In this case BellSouth can't argue any of them. They don't have the law on their side; they don't have the facts on their side, and it's not fair to ask you to make a cost proceeding out of this docket when the little guys to whom the costs are intended to apply haven't received any notice.

I'm going to ask you again, please read Section 271. Please read Section 272. Read paragraphs 110 and 114 of the Ameritech decision. Read the FAW notice. And after you read them I think you're going to come to the conclusion that this is not the proper proceeding for a SGAT. Thank you.

MR. CARVER: May I make two brief points in response?

CHAIRMAN JOHNSON: Briefly.

MR. CARVER: First of all, I just want to make a general point, which I believe at this point Ms. Rule has begun to argue the substance of SGAT approval.

I listened to, a second time, her cost-based arguments, and in effect she's trying to argue to you that the SGAT shouldn't be approved as opposed to arguing that it's not properly before the Commission.

I think the way she did it it points out something that's very important and that's the fact that Mr. Scheye and other BellSouth witnesses were cross examined last week at great length about this. And what she's in effect doing is arguing to you the evidence, which would be appropriate if the question were whether the SGAT should be approved. It's not really appropriate for arguing that the SGAT is not properly before the Commission.

And I think, again, that this approach simply points up the fact that this has been a part of the case for the last week. There has been extensive inquiry about it. And I think Mr. Scheye addressed this at great length in the testimony he gave from the stand. And at this time I think it is in the case.

COMMISSIONER KIESLING: Mr. Carver, I have a problem with that argument. And the problem I have is that if this motion had been argued before we started with evidence, then they wouldn't have had to cover all their bases and guess what we might rule. They had to cross examine your witnesses on these issues because it was their only shot at it. And the reason we didn't rule on this motion earlier was in deference to your need for more time to respond; not because, you know, we wanted them to go through having to cross

examine everyone. I mean they did the only thing they could do.

MR. CARVER: Yes, ma'am, I would agree with that. We appreciate having had the opportunity to respond to this before we argued it. But I just want to clarify one thing about the position I'm taking.

I'm not saying there's anything wrong with their cross examining. I'm not saying that by cross examining they have waived. What I'm saying is that by cross examining they obtained information which they are now using to argue that the SGAT is insufficient. And I don't think the real issue is whether or not the SGAT should be approved; at least not for purposes of this motion. The question is whether the SGAT is properly part of the case.

So I don't have a problem with their conducting the cross examination. That's their right to do it. And I agree that under the circumstances they had to. I'm just saying that what they are doing with what they've obtained is saying don't allow the SGAT in the case, because in every instance the cost support is no sufficient. That's an argument that goes to the merits. And that's an argument that should properly be considered for purposes of deciding approve it or not approve it, but it's not a reason to

keep it out of the case.

The only other thing I wanted to note in closing is that I took a quick look at the Florida Rules of Civil Procedure and the only reference that I could find that's striking, that jumped out at me was a Motion to Strike that was referred to in Rule 1.140. I'm not sure it's that helpful. It just says that "A party may move to strike matters that are redundant, immaterial, impertinent or scandalous." So that's the standard for a Motion to Strike.

The motion for severance, which I referred to previously, was in Rule 1.270, it's titled "Consolidation" but I think the language regarding separate trials in subpart B really gets to the motion to sever what should be considered. That's all I have. Thank you.

CHAIRMAN JOHNSON: Ms. Rule.

MS. RULE: Well, I'm told by Trawick's that two types of motions to strike are authorized by Rule 1.140. One is used as Mr. Carver said, to eliminate immaterial, redundant, impertinent or scandalous allegations and it is discussed in this section of Trawick's, although you could, of course, make a sugestion it's impertinent of Bell South to do this. I think the real objection is that it's

immaterial.

The other, however, is stated as being used to test the legal sufficientcy of a defense. I think what we're doing here is testing the legal sufficiency of BellSouth's case.

CHAIRMAN JOHNSON: Commissioners, any questions? Staff, did you have any questions?

COMMISSIONER DEASON: I have a question for Ms. Rule.

Is it your position that because BellSouth has indicated they're going under Track A, that by the language of the Act we are prevented from considering an SGAT?

MS. RULE: No, sir. As I stated you are free to offer the FCC whatever consultation you wish. If you wish to examine the SGAT, you most certainly may do so. BellSouth could have proposed one long before. And certainly an SGAT is a good thing. And as they've stated it does allow the little guys a way to get into business without a lengthy and expensive arbitration or negotiation. However, it's not properly before you in this docket and it doesn't relate to a Track A filing.

COMMISSIONER DEASON: When you say not properly before us, why is it not properly before us?

MS. RULE: Several reasons, but the most important -- well, one reason is based on federal law; it's simply irrelevant to a Track A filing. But the more important reason for you today is that it hasn't been properly noticed. Agencies in Florida are required to give --

COMMISSIONER GARCIA: Ms. Rule, if it's irrelevant, then why are we discussing it? What is the significance of it? If -- it worries me, the argument worries me that AT&T is looking out for the little guy here.

MS. RULE: I'm not arguing that AT&T is looking out for the little guy.

COMMISSIONER GARCIA: You're the only one arguing for the little guy here. What I want you to get back to is if it's irrelevant, then why bother with it? Why bother with this Motion to Strike if it is irrelevant to the track that Southern Bell is on, why are we worried about it?

MS. RULE: Well, we have to worry about it because BellSouth has put it at issue.

COMMISSIONER GARCIA: I'm sorry, Commissioner Deason, I jumped in --

MS. RULE: As intervenors we have to worry about it because BellSouth puts it at issue. We

believe it's not properly at issue. But once they raise it we have two choices: respond or not. And we've chosen to respond. We believe that's the proper course of action.

Now, I'm not sure I fully answered your question. Did you have another part to it?

COMMISSIONER GARCIA: No. I don't think you have answered the question. I understand that you're arguing against it. That's clear. But I'm saying if it's irrelevant to our determination, what does it matter if it's part of the evidence or not, or if it's in the record or not?

MS. RULE: Well, because procedurally it's not --

COMMISSIONER GARCIA: It's irrelevant in the standard that the FCC is committed anyway.

MS. RULE: That's correct.

COMMISSIONER GARCIA: And you mean it's unnecessary before us.

MS. RULE: That's correct. And had BellSouth properly brought before you an SGAT, I wouldn't be sitting here making this argument.

They are entitled to rely on whatever evidence they want at the FCC. If they want to take a SGAT to the FCC in spite of the FCC's clear order in

the Ameritech decision that they want to see interconnection agreements and how those have been implemented, that's certainly up to BellSouth.

COMMISSIONER GARCIA: Wouldn't it be better if they are going to possibly take this before the FCC that we have something that at least this Commission has looked at? As opposed to something that we haven't looked at, going up to the FCC? In other words, giving you the opportunity to discuss it here before us in this state so that we have an idea of what's going on up there? So that at least in that part of it it's through us that it goes up there?

MS. RULE: No, sir, and here's why.

COMMISSIONER GARCIA: Okay.

MS. RULE: This hasn't been properly noticed. As BellSouth pointed out -- and BellSouth is here arguing this is the great thing for the little guy and all the mean intervenors don't think like it. But if BellSouth wanted an SGAT, it could have done it right. It had myriad opportunities over the course of the last year to put an issue in this case and it didn't do it. It hasn't even filed an SGAT for you to review. It's been a moving target all the along and we've been doing our best to try and hit. But BellSouth's actions have resulted in a deficient

notice in this case.

You are required -- and this goes back to your question too, Commissioner Deason -- you are required as an agency in Florida to offer a clear point of entry into the agency's determination process. That FAW notice simply doesn't do it. It doesn't put anybody on notice that you're going to engage in a cost setting proceding. You're making rates here and you haven't told anybody that that's what you're going to do. And it's not the fault of Staff and it's not the fault of intervenors. It's BellSouth's fault for not putting that at issue.

MS. BARONE: I have one question for BellSouth. It appears that you are, as you say, proceeding under Track A. My question to you, then, is if that's your position at this time, would it be prudent to take out the issues on Track B at this stage?

MR. CARVER: No, I don't think it would be prudent. And, actually, this is something that I guess we've argued at great length previously when these same parties moved to strike Track B. And what I'd say now is the same thing that I said then, which is that we believe we're Track A compliant.

We hope that this Commission's factual

findings will support that and that we'll have a record that we can take to the FCC, but it may not come out that way.

I mean, it may vary -- well, I don't want to say "very well," but there's at least a possibility that you'll scrutinize the people that have actually entered and decide that Track A hasn't been met. And then the question comes up, well, if Track A is not open, is Track B open or, as I assume they're going to argue, are we in some sort of limbo; because our position is that if we haven't met Track A, then Track B should be looked at. And I think whether we're Track A or Track B is something that ultimately the FCC is going to have to decide on the basis of the facts put before them. And we're trying to do here is to develop as complete a factual record as we possibly can.

And I just have to say that Ms. Rule answered Commissioner Garcia's question say, no, the Commission didn't need to develop a full factual record, or -- I don't want to misquote her, but I think that was the gist of it. I disagree with that very much.

I mean, since this decision will ultimately be made by the FCC, I think it's extremely important

for this Commission, in performing its consultative role, to gather as many facts as you can and consider as many things as you can.

I believe the SGAT should be approved, but if you see it differently, then I think it's appropriate to have it in the case and to not approve it. I don't think it's appropriate to strike it from the case.

COMMISSIONER DEASON: Mr. Carver, that leads me to, I guess, my final question; hopefully, my final question.

You would rather us go ahead and consider the SGAT in this proceeding even though the decision may be that it not be approved?

MR. CARVER: Yes -- well, yes, we would, because, first of all, we think it should by approved; but, secondly, if you don't approve it, hopefully you'll at least give us some guidance as to where you believe it falls short, and then if we need to make a subsequent filing, then we will have that guidance.

I guess the other side of the coin of finding facts is what comes out of the factual determination. So even if the SGAT were not approved, I believe that the process and the findings of the Commission would be helpful to everyone to give them a

better idea of what this Commission would believe to be checklist compliant.

So the short answer to your question is, yes, we would rather have it a part of the proceeding even if ultimately it's not approved, because I don't think that would foreclose us from trying again.

COMMISSIONER DEASON: In your -- that wasn't my last question, I guess, after all. You've completed your direct case. In fact, you've completed your rebuttal case; is that correct?

MR. CARVER: Well, yes, we have --

COMMISSIONER DEASON: I guess Mr. Scheye -- I mean, I'm sorry -- Mr. Stacy may be recalled for some further recross-examination or whatever?

MR. CARVER: Right. But to the extent we're not putting him up any more, I would say, yes, we've completed our case.

COMMISSIONER DEASON: So all the evidence that you want us to rely upon to approve your SGAT is in the record?

MR. CARVER: All that we've presented. I mean, hopefully we can elicit some more things through cross-examination and their deposition --

COMMISSIONER DEASON: But it's your burden --

MR. CARVER: Yes.

COMMISSIONER DEASON: -- and you have to go forward with that. You can't depend upon cross-examination to meet your burden.

MR. CARVER: That's true. I would say -- I agree with that procedurally. I would say that in this particular circumstance I think what interconnectors are doing with their agreements is something that should be considered. And in a lot of instances we don't really know what they're doing with their agreements because they won't tell us.

So, you know, in many instances we may be asking them questions and, hopefully, they will tell the Commission whether they're competing or not competing or trying to get into the market, and we believe that that should be considered.

So I guess the one caveat is, is because of the unique procedural stance of this, I think there's some information that's going to come out on cross-examination that should be considered. At the same time, I agree with your point, Commissioner; it is our burden to go forward.

COMMISSIONER CLARK: Ms. Rule, I want to be clear as to what you're asking for. Is this a motion to strike?

MS. RULE: Or in the alternative, sever the SGAT from this proceeding for separate consideration.

COMMISSIONER CLARK: And you said a motion to strike is for two purposes. What are those two purposes? You quoted Trawick.

MS. RULE: Two reasons for a motion to strike: One is to test the legal sufficiency of a defense. In this case it would be the case. And the other would be to strike immaterial, redundant, impertinent or scandalous allegations.

COMMISSIONER KIESLING: Well, I need to be clear since I don't have Trawick in front in me. Generally, when I think of using a motion to strike defenses, which is the one you're trying to rely on, what we're talking about is striking affirmative defenses, not striking the actual petitioner's case or parts of it.

MS. RULE: That's correct. Yes, you're right.

COMMISSIONER KIESLING: So that's not quite the same as what you characterized as what you're trying to use that part for.

MS. RULE: No. I believe it's more because it's immaterial, but as I mentioned to Commissioner Clark, I really haven't researched this.

Mr. Hatch very kindly handed Trawick's to me.

COMMISSIONER KIESLING: With the pertinent parts underlined.

MS. RULE: Well, not enough pertinent parts as it turns out. I really wish he had underlined a bit more for me.

COMMISSIONER DEASON: Ms. Rule, contrast for me what you're seeking here to what was considered by the Commission, I don't know, some month or two ago concerning the scope of this proceeding and that was denied by the Commission -- I think I dissented against that at that time -- but that was denied at that time that we were going to consider Track A and Track B. Compare -- I mean, tell me what's different now from what we considered then.

MS. RULE: Well, a couple of different things. The main one that comes to mind is that the FCC has issued its Ameritech order explaining what or what types of evidence it's going to consider in connection with a Track A filing, and it's specifically stated in those paragraphs I handed out to you -- and I've given you the fuller version in the other material -- it's specifically stated for Track A the applicant lives or dies by the interconnection agreements, not an SGAT.

So that's one thing. And the other thing is BellSouth has now declared to you and testified to you that they're proceeding under Track A. And if you'll recall, at the time you heard the last motion the Ameritech order hadn't come out and BellSouth did not state which way it wanted to go; and, in fact, it specifically reserved the right to go either way. But you've heard now it's a Track A case.

Also you've heard testimony, and I think that's a big difference.

MR. CARVER: May I comment on that briefly? Our position in response to this motion all along is that in effect it's a motion to dismiss. I mean, they tried to dismiss Track B. That motion was denied. Now they're trying to in effect strike all of the evidence that relates to a Track B consideration.

It really amounts to the same thing. And, properly, this really isn't a motion to strike, it's a motion to dismiss.

I think what Ms. Rule told you are two substantive reasons why, in effect, they're arguing that a motion to dismiss is better taken today than it was a month or two ago. But in terms of what they're really asking for and the effect it's going to have on the proceeding, I don't think their comments really

address. And I think because, in effect, what's happening here is they're asking you to take one of the two things we're seeking. That is, in effect, a fact record and a determination on A and a fact record and a determination on B.

They're asking you to take the Track B portion of it and simply remove it from the case, not to have any facts, not to have anything the FCC can rely upon and, in effect, not to have Track B as part of the proceeding.

So I believe the short answer to the question "how is it different" is, in effect, it really isn't any different.

COMMISSIONER GARCIA: I don't know if it's been repeated by the parties enough times to convince me or I just missed it, but -- and I believe you said it, too, so -- that this proceeding is basically about Track A, that that's the track that you are trying to get to in this proceeding.

MR. CARVER: Yes, sir. Our view is that we meet Track A, and we believe the facts support that. We hope the Commission will reach that decision, also. But at some point we're going to have to file an application with the FCC, and there will be a factual record made here and there may be other things that

come into consideration.

And one possibility -- I hope it doesn't happen -- but one possibility is the Commission may look at everything we have here and say, no, you're not Track A compliant.

Now, if -- in our view, if we're not Track A compliant, then it raises the question of why. And some of those reasons put us back on Track B, if like, for example, if you looked at --

COMMISSIONER GARCIA: -- including if you were back on Track B, we're not going to make that determination, but you would think that that record, then, would apply to the FCC.

MR. CARVER: Yes, as --

COMMISSIONER GARCIA: Or you would take that forward to the FCC?

MR. CARVER: Yes, sir. Essentially, the record that's created we hope will be broad enough so that it will give us some guidance as to whether Track A or Track B is appropriate. But what they're arguing is the situation, in effect, where you get rid of B now and allow A to be the only possibility. Then if you find that we're not Track A compliant, then we're nowhere.

And our hope since A -- or lack of A can

turn back to B, we believe it's important to have a full factual record, because some of the reasons that might lead to a denial of A would also support the B -- a Track B application. We --

COMMISSIONER GARCIA: Ms. Rule, if --

MR. CARVER: I'm sorry.

COMMISSIONER GARCIA: If we knew that Southern Bell was going to use Track B for a while, then how can -- how could it have escaped you that it's not an issue in this case? How could it escape the parties?

If we knew that they were presenting Track B and ruled on it, and I -- I don't remember if anyone even did dissent.

MS. RULE: Commissioner, we didn't know they were presenting Track B, and they refused to tell you. I believe Commissioner Deason asked a direct question, and the response was that they're not ready to tell you. Clearly we can't read their minds.

I'd also like to point out to you that the Kentucky PSC dismissed their SGAT. A Kentucky PSC found that Track B was closed to BellSouth.

I'd also like to remind you that at Paragraph 130 of the Ameritech Order we find that the Michigan Commission dismissed or rejected Ameritech's

SGAT because Ameritech didn't qualify for Track B. Why? Competitors had made timely requests for action and interconnection.

COMMISSIONER CLARK: Now, Did the FCC do that or did Michigan do that?

MS. RULE: The Michigan PSC did that.

COMMISSIONER CLARK: What did they do?

MS. RULE: I will quote to you from footnote No. 130 of the Ameritech order.

COMMISSIONER CLARK: Of what?

MS. RULE: Of the Ameritech order.

COMMISSIONER CLARK: From the FCC.

MS. RULE: Yes. And It says -- cites some material from the Michigan consultation, and it says "Indicating that the Michigan Commission rejected Ameritech's statement of generally available terms and conditions on the ground that Ameritech does not qualify for Track B because competitors had made timely requests for access and interconnection.

COMMISSIONER CLARK: Did they strike it or they just reject it?

MS. RULE: Reject it. But your procedural posture is different. You're being asked to turn this into a ratemaking proceeding. There are no issues before you. There's no notice to parties who aren't

here.

COMMISSIONER DEASON: Ms. Rule, doesn't that go to their burden, though, as to whether they've met their burden to have an SGAT, as they have filed it, approved by this Commission at this time?

MS. RULE: If it were properly noticed, I would agree with it, but it's not properly noticed. You're being asked to set rates. You haven't given anybody any notice that you're going to do that. BellSouth hasn't given the public any notice that it's requesting that. The notice is procedurally deficient.

COMMISSIONER DEASON: Is anyone harmed if SGAT is not approved in this proceeding?

MS. RULE: If it's not approved in this proceeding, BellSouth has the opportunity to file it again or you could choose to sever this proceeding, notice it properly; hold another hearing or not. You could, I imagine, do it as a PAA if you find there's sufficient evidence for you to do that.

But in any event, I don't know if anybody is prejudiced. Those people aren't here. They haven't been given notice.

COMMISSIONER GARCIA: Are you saying we could do it as a PAA within this order in this case?

MS. RULE: No, because this case hadn't been properly noticed. You have the ability to open any --

COMMISSIONER GARCIA: That's what I though. So I didn't understand if you had answered Commissioner Deason's question directly, which was "who is hurt if we don't." Is it -- am I correct?

MS. RULE: That's like saying "Who has not received notice." I don't know, but the notice requirements are intended to give the public at large an idea of what's going on in this case.

COMMISSIONER DEASON: But now you would agree that when it comes to notice, that it is not practical for this Commission to lay out within the notice every conceivable issue which is going to -- if this were a rate proceeding -- and you've gone through rate proceedings before -- it's not unheard of to have 100 issues.

The notice is not required to list out 100 issues as to what there's going to be an affirmative vote on at the time of agenda conference to determine what the outcome of that case is going to be. Now, how is this different?

MS. RULE: You are absolutely correct, but I invite you to take a look at the title of this docket, "Consideration of BellSouth Telecommunication, Inc.'s

entry into intraLATA services pursuant to Section 271 of the Federal Telecommunications Act of 1996."

This is a 271 proceeding. You've noticed it as a 271 proceeding. Nothing in 271 authorizes you to approve an SGAT. That authority comes from Section 252, and you haven't noticed this as a 252 proceeding.

COMMISSIONER GARCIA: Isn't part of 271 -- considers that SGAT? Isn't the Track B necessarily considering that SGAT?

MS. RULE: Not necessarily. And even so, if you look at the language of the Act, that would be an existing SGAT. Look at the issue this case. Do they have one? Has it been approved by the Commission? Has it been permitted to go into effect.

COMMISSIONER DEASON: Ms. Rule, you would agree that the so-called little players out there, they have the opportunity, if they want to, to just say, I want AT&T's agreement or, I want MCI's agreement. They don't have to depend on the SGAT if they don't want to.

MS. RULE: They don't have to, but I would say that the little guys don't have AT&T's ability to negotiate an agreement, and the agreement we've negotiated is specific for our business needs. As BellSouth said, if they wanted an SGAT, it's so people

don't have to do that.

COMMISSIONER CLARK: I'm not sure I agree with your notion that this is a rate case and that all customers are entitled to notice. This is the setting of the rates between companies, not with respect to ratepayers. So I'm not sure I can buy into your notion that there hasn't been proper notice of this. But I see this more -- I see our role as consultative with the FCC, and I think that the Ameritech order kind of sets out -- the part you read, at least, is that if we believe that it isn't adequate, we should recommend to them that they reject it and that we think it's not appropriate under B.

I just don't know if it is wise for us at this time to strike it or sever it. I think we ought to take it what it is and comment on it and send it up to the FCC.

COMMISSIONER DEASON: Let me offer some comments to -- I'm in basic agreement with you.

When we considered the question, the scope of this proceeding and whether we were going to go to Track A or Track B or whatever, I thought that's what we should do. We were at the stage of the hearing where we should have specified, if we were so inclined -- and I felt it was appropriate to specify

we were just filing it -- discovered this case was going to be Track A. And part of that reason was so that we could hone the issues, focus on what was important, focus on that 14-point checklist as it pertained to the arbitrated agreements, and forget about this SGAT, because I don't think it was relevant at the time. I don't think it perhaps is relevant now. And I thought that it was an expeditious thing to do.

But the fact of the matter is we've already done all the work now. We have sat here for a whole week and listened to all of the direct case, the rebuttal case, and at some points your excruciating cross-examination. (Laughter)

The work has been done. There's nothing to be gained. Now the case is in, the evidence is in, and this Commission will have to decide whether we're going to approve the SGAT or not.

So I don't think there's anything to be gained by severing it off. And I agree with Commissioner Clark; I don't think the notice is deficient. Anyone that is familiar enough to know what 271 is, they know what an SGAT is, and they better look in here to see if there's going to be an issue as to SGAT, if they're concerned whether they're

going to be harmed by a SGAT being approved in this proceeding.

So for those reasons, I would make a motion that we deny the motion to strike or, in the alternative, to sever the issue from this proceeding.

CHAIRMAN JOHNSON: There's been a motion. Is there a second?

COMMISSIONER CLARK: Second.

CHAIRMAN JOHNSON: There's a motion and a second. Any further discussion?

COMMISSIONER KIESLING: Yes. I want to indicate, since a number of my questions may have suggested otherwise, that I'm in agreement with the motion. I do not feel that --

COMMISSIONER CLARK: Which motion? The one we've made or the one they've made?

COMMISSIONER KIESLING: The motion that was just made by the Commission. (Laughter)

I think that a question that is legitimately before us in regard to the SGAT is whether or not BellSouth has presented sufficient evidence to support our approval of the SGAT. And I certainly think that all the information is in the record and that the whole record should go forward to the FCC.

I see this case a little differently because

it is a consultative role. It's not the traditional kind of 120 hearing that we do. And my preference would be that we air all of it here. We hear the witnesses. We've already gone through -- I would have used instead of "excruciating," maybe "tedious," but there's a number of adjectives that would work -- cross-examination on these things, and I think we should just go forward with the case as it is.

I don't think that the notice is necessarily deficient because this is a consultation proceeding as opposed to a formal proceeding where we are going to, in essence, set rates.

So I think it's a legitimate issue is before us in 1B, and that is whether or not we should approve the SGAT. If we don't approve the SGAT, then that's what goes forward to the FCC.

COMMISSIONER CLARK: I think even if we struck it, they would still have the opportunity to send it.

COMMISSIONER KIESLING: Well, that's my concern.

COMMISSIONER CLARK: So it would be well to sort of leave it in there and provide our views on it.

COMMISSIONER KIESLING: I am in agreement. If we're supposed to consult with the FCC and give

them, you know, our whole record of what we've heard here, then I think we should give them the most complete record possible. So I am going to vote for the motion, but I just didn't want anyone to think that --

COMMISSIONER CLARK: And while we had talked about the cross-examination, it has been, you know, difficult at times, but I think it's been well worth it in the sense of illuminating those areas of particular problems, and my hope is that -- you know, there's not only the benefit of having this information to send to the FCC, it's a benefit between the parties so you can resolve your differences, because the objective here is not to keep one or the other out of the other market. The objective here is to get it fair so customers have a choice.

I mean, I get tired of my relatives saying when. When are we going to get a choice? When am I going to get a choice?" I'm ready to go now. So I think, you know, not just to send it to the FCC, but hopefully you all are learning where your real disagreements are and what you need to work on.

COMMISSIONER DEASON: Let me clarify something. My use of the term excruciating was not intended -- (Laughter)

COMMISSIONER CLARK: Some of us need it three times. You only need it once.

COMMISSIONER DEASON: -- was not intended to be derogatory towards those persons conducting the cross-examination. What it intended to relay was the fact that these are very complicated issues, and if we had granted the motion to start with, we would not have had some of this excruciating cross-examination.

But this Commission decided we were going to leave open Track A and Track B and leave SGAT in there, and so it was necessary. And my point is that we've done the work now, and there's not a lot to be gained by kicking it out at this point. The evidence is in, and we can make a decision on the SGAT. And I'm ready to go forward.

CHAIRMAN JOHNSON: There is a motion and second. All those in favor, signify by saying aye.

(Affirmative responses.)

CHAIRMAN JOHNSON: Show it approved unanimously and the motion denied.

COMMISSIONER GARCIA: The words you were looking for was "painfully proficient." (Laughter)

COMMISSIONER DEASON: I'll try to remember that next time.

CHAIRMAN JOHNSON: We're going to take a

10-minute break.

(Brief recess.)

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CHAIRMAN JOHNSON: We'll go back on the record. I think we're ready for our next witness. And there may be some preliminary matters. Let's go to the preliminary matters.

MR. HATCH: There's a couple preliminary matters. I think the next one on the agenda, Commissioners, is there is still a pending dispute with respect to BellSouth and AT&T and the other members of FCCA with respect to the production of documents that we received last week.

I'm about to hand you a document that are extracts of some of the information in the material that was produced by BellSouth to FCCA. It is highly proprietary. That's why I'm handing you this out. What I would request at the moment is that you enter a temporary protective order that would protect it from public records disclosure while it's in the Commission's hands, and then after we're done with the argument, then we can gather these sheets back up. So I'll go ahead and hand those out now if I can have a protective order.

CHAIRMAN JOHNSON: How do we handle this,

Staff, this document that he's referring to?

MS. CULPEPPER: I believe what Mr. Hatch suggested will be appropriate, a temporary protective order.

CHAIRMAN JOHNSON: That we grant that temporary protection order now. Okay. Then we'll grant the temporary protective order. And I'm sorry. I didn't catch the first part of your statement. How is this being used?

MR. HATCH: Okay. What you have before you is information that has been drawn from the interconnection agreements that BellSouth has with other ILECs and you can go through there. The first page is basically a summary of the basic agreement that BellSouth has with all of the LECs, and then as you go through you can see for each LEC which piece-parts they have with respect to their agreements with BellSouth.

The reason I'm giving you this sheet is because I can show you it without having to talk about it and disclose it, which was one of the problems of trying to get ready to do any cross-examination on it.

Essentially the posture we find ourselves in is that I had proposed to BellSouth that we basically go ahead and stipulate the contracts into the record

and that we could argue the information in them with respect to our cases when we file the briefs.

BellSouth still claims, or still is arguing, that the information is irrelevant, and essentially that's what Ms. White and I are going to argue about now.

Commissioners, what you see before you is essentially the substance of all those interconnection agreements. As you recall from the beginning of the hearing last week, Commissioner Johnson had issued a ruling that the information was relevant to produce. The Commission had denied BellSouth's motion for reconsideration, that these documents are relevant and should be produced.

What I am asking today is that these documents be entered into the record in this proceeding. Because of the lateness in which we got them and because of the difficulties of trying to structure cross-examination from these documents, this seemed to me the most expedient solution -- if you'll forgive the word -- for getting information into the record for subsequent use.

These contracts are, as you can see from the services covered with respect to companies, they're directly on the issues in this case with respect to

whether BellSouth is providing nondiscriminatory access as well as other services that are relevant within the 14-point checklist.

We still maintain that these documents are directly relevant. They directly show what BellSouth is doing with some of its competitors. Then the question then becomes what is it doing with all of its competitors and is it relevant to that determination?

CHAIRMAN JOHNSON: BellSouth?

MS. WHITE: Yes. Thank you. Chairman Johnson, you, as the prehearing officer, decided that these documents were relevant for purposes of discovery, and on reconsideration the Commission agreed with you.

Now AT&T and the other members of the FCCA are asking that these documents be included into the record; moved into the record. So it's not just for discovery purposes anymore, it's for purposes of entering them into the record.

BellSouth would object to the documents coming into the record for the same reasons it objected on discovery; that interconnection with the incumbent local exchange companies was not provided under the Act, it was not negotiated under the Act and, therefore, it is not relevant to what BellSouth

is providing under the Act. Thank you.

CHAIRMAN JOHNSON: Staff?

MS. CULPEPPER: Commissioners, Staff recommends that the evidence appears relevant for the purposes of determination under Section 271. Therefore, we would recommend that the evidence be admitted but accorded whatever weight that it may be due.

CHAIRMAN JOHNSON: Commissioners, any comments? And are you at this time asking us to mark this?

MR. HATCH: Yes, ma'am; that would be my next request is that the interconnection agreements be marked for identification as a composite exhibit. I don't know what the next number is.

CHAIRMAN JOHNSON: Okay. And how do we handle that with the confidential document?

MR. HATCH: I will provide a copy I have. Actually, it's a box. I will provide the box to the court reporter with that exhibit number on it.

MS. CULPEPPER: Madam Chairman, may I ask Mr. Hatch if he would clarify for us? We just looked over this document, and we're not sure exactly what information in here is exactly supposed to be confidential, because it appears to us some of this

has actually been filed.

MR. HATCH: All of the information in this handout that I handed to you comes directly out of the documents produced. BellSouth has claimed that those documents are proprietary. So rather than get into the nuances of which piece is and which piece isn't, which can be solved later, this seemed to be the best way to handle it.

MS. WHITE: Well, if I could just have a clarification. You're not moving this handout into the record, you're moving the actual agreements themselves into the record?

MR. HATCH: That is correct. The handout I was going to pick back up. It was solely for illustrative purposes for argument. The handout is not the exhibit. The documents themselves, the contracts, are the exhibit.

MS. CULPEPPER: Thank you.

CHAIRMAN JOHNSON: We will mark as Exhibit 66 the interconnection agreements with the ILECs, and Mr. Hatch will provide those to our court reporter. And you've moved that?

MR. HATCH: Yes, ma'am.

CHAIRMAN JOHNSON: I'm going to admit that. I do believe that it is relevant, and to the extent

that there are arguments that can be made, they will go to weight and not admissibility.

Any other preliminary matters?

(Exhibit 66 marked for identification and received in evidence.)

MR. HATCH: One final matter. Dr. Kaserman is technically the next witness up in the lineup. We have agreed to stipulate him into the record, if you want to handle that now.

Dr. Kaserman has prepared 59 pages of rebuttal testimony including end notes, and we would request that that be inserted into the record as though read.

COMMISSIONER KIESLING: I'm sorry. Did you say Robert?

MR. HATCH: Dr. Kaserman, David Kaserman.

COMMISSIONER KIESLING: That's what I thought. That's why I was confused about --

MR. HATCH: If I said Robert, I misspoke. I'm sorry.

CHAIRMAN JOHNSON: It will be admitted inserted into the record as though read.

MR. HATCH: Dr. Kaserman had also prepared six exhibits, DLK-1 through DLK-6. Could I request they be marked for identification?

CHAIRMAN JOHNSON: They will be marked as exhibits -- Composite Exhibit 67.

MR. HATCH: And we would request that Dr. Kaserman's exhibits also be admitted into the record.

CHAIRMAN JOHNSON: They will be admitted without objection.

(Exhibit 67 marked for identification and received in evidence.)

I. QUALIFICATIONS AND PURPOSE OF TESTIMONY

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David L. Kaserman. My business address is the Department of Economics, College of Business, 415 West Magnolia -- Room 203, Auburn University, Auburn, Alabama, 36849-5242.

Q. WHAT IS YOUR OCCUPATION?

A. I am an economist. My current position is Torchmark Professor of Economics at Auburn University.

Q. WOULD YOU PLEASE SUMMARIZE YOUR QUALIFICATIONS?

A. Yes. I hold a Ph.D. degree in Economics from the University of Florida. My principal field of interest is industrial organization, which encompasses the areas of antitrust economics and the economics of regulation. I have over twenty years of experience as a professional economist and have held positions both in government agencies (e.g., the U.S. Federal Trade Commission) and in academic institutions. In addition, I have consulted on and testified in numerous antitrust cases and regulatory hearings. My primary research interest is in the application of microeconomic analysis to public policy issues, and that interest is reflected in my publications.

Over the past twelve years, I have focused much of my research on public policy issues surrounding the telecommunications industry, particularly those issues created by the emergence of competition in the various markets that comprise that industry. That research has resulted in the publication of more than a dozen papers on this subject, with several more papers currently in progress. I have also published a textbook, co-authored with Professor John W. Mayo at Georgetown University, dealing with the economics of antitrust and regulation. In addition, over this same period, I have testified on telecommunications policy issues in more than fifteen states and before the Federal Communications Commission.

Q. HAVE YOU PREPARED A VITA THAT DESCRIBES YOUR EDUCATION, PUBLICATIONS, TESTIMONIES, AND EMPLOYMENT HISTORY?

A. Yes. A copy of my most recent vita is attached as Exhibit 1.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. I have been asked by MCI Telecommunications Corporation ("MCI") and AT&T Communications of the Southern States, Inc. ("AT&T") to respond to several of the economic arguments presented by Mr. Alphonse Varner, of BellSouth Telecommunications, Inc., in his direct testimony in this proceeding. In that testimony, Mr. Varner attempts to support BellSouth's

application to enter the interLATA long-distance market within Florida under the provisions of Section 271 of the Telecommunications Act of 1996. This Section of the Act establishes the criteria under which the Regional Bell Operating Companies (RBOCs) will be allowed to enter (or, more accurately, reenter) the in-region interLATA market.[1] Specifically, under the 271 provisions, an RBOC's reintegration within its certificated geographic territory is made contingent upon the satisfaction of four necessary preconditions.[2]

First, the RBOC must be able to demonstrate that it is providing interconnection to competitive local exchange providers (at least one of which is predominantly a facilities-based carrier). Moreover, the terms and conditions under which the RBOC offers interconnection must conform to the standards established by a "competitive checklist" contained in the Act.

Second, the RBOC seeking approval to reintegrate must comply with the Act's nondiscrimination and structural separation requirements. Importantly, the Federal Communications Commission (FCC) has interpreted these provisions to mean that not only must the RBOC refrain from discriminating among third parties, but regulators must also be able

to establish that the RBOC does not discriminate between itself (or its subsidiaries) and third party providers.[3]

Third, the Act requires the FCC to seek advice from the U.S. Department of Justice (DOJ) concerning each RBOC application. In conducting its evaluation of a 271 application, the latter agency may apply any standard that it deems appropriate. Although the resulting DOJ recommendation is not binding on the FCC's decision, the Act requires that "substantial weight" be given to it.

Finally and importantly, the Act explicitly instructs the FCC to deny the application unless it finds that the requested reentry is consistent with the "public interest." From an economic standpoint, such a determination would appear to require that the benefits accruing to telecommunications consumers exceed any potential harm to those consumers as a result of the reintegration.

The above criteria are clearly intended to establish some threshold level of competition in local exchange markets as a prerequisite to RBOC reentry into long distance. The crucial question, then, is what that level of competition will be. The action taken by this

Commission on BellSouth's application, along with the actions of the other regulatory and antitrust agencies involved in the 271 process, will determine the answer to that question.

Q. HOW IS YOUR REBUTTAL TESTIMONY ORGANIZED?

A. My testimony is organized in four substantive sections. The first two sections deal with the current intensity of competition in the interLATA and local exchange markets, respectively. The question of whether and to what extent competitive market forces are present in these two markets largely determines the merits of allowing BellSouth to reintegrate at this time. In my opinion, Mr. Varner has seriously misstated the status of competition in Florida's interLATA market, resulting in an erroneous conclusion concerning the likely effects of reintegration on the welfare of the consumers of this state.

The third substantive section then reevaluates Mr. Varner's conclusions regarding the likely economic effects of allowing BellSouth to reintegrate into the interLATA market at this time. Due to Mr. Varner's erroneous conclusions regarding the intensity of competition in the interLATA market and his failure to address the state of competition in local exchange markets in Florida, his conclusions concerning the probable consequences of BellSouth reintegration are also mistaken.

The fourth substantive section then responds to three additional economic issues raised in Mr. Varner's testimony. These issues are: (1) the alleged benefits of allowing BellSouth to reenter the interLATA market to provide consumers bundled service offerings (the one-stop-shopping argument); (2) the claimed ability of regulation to successfully safeguard the public (both consumers and competitors) from any anticompetitive behavior that might be exhibited by a reintegrated BellSouth; and (3) the allegation that price cap regulation eliminates incentives for BellSouth to misallocate its costs in order to cross-subsidize competitive services in a reintegrated environment. A final section then summarizes the testimony.

II. COMPETITIVENESS OF THE LONG-DISTANCE MARKET

Q. AT SEVERAL POINTS IN HIS TESTIMONY, MR. VARNER ARGUES THAT THE LONG-DISTANCE INTERLATA MARKET IS NOT SUBJECT TO EFFECTIVE COMPETITION (E.G., PP. 6 AND 60-61). HOW IS THIS ISSUE RELEVANT TO THE SECTION 271 DELIBERATIONS?

A. The intensity of competition in the interLATA market is relevant to the decision of whether to approve BellSouth's 271 application in at least two respects.[4] First, BellSouth argues that the interexchange industry currently

is characterized by monopoly (or, at least, by the absence of effective competition) and, therefore, that reintegration by BellSouth will increase competition and, thereby, enhance consumer welfare. If, alternatively, the interexchange industry is subject to effective competition, then the market is already providing virtually all of the consumer benefits possible. In that event, reintegration will not yield the benefits claimed by Mr. Varner. Second, if the interLATA market is competitive and local exchange markets are not, then the very real potential for monopoly leveraging behavior arises with reintegration. In that event, it is likely that BellSouth's reentry into the interLATA market will actually cause a reduction in the intensity of competition in this market. As a result, an affirmative case for RBOC reintegration hinges largely upon the argument that the interLATA market is not yet subject to effective competition. Consequently, that argument provides an important cornerstone to BellSouth's application in this proceeding.

Q. IS THE INTENSITY OF COMPETITION IN BELLSOUTH'S LOCAL EXCHANGE MARKETS ALSO RELEVANT TO THIS PROCEEDING?

A. Yes. If consumers are to benefit from BellSouth's reintegration into the in-region interLATA market, effective competition must first prevail in its local exchange markets. The competitive checklist provided by Section

271 (c)(2)(B) represents a necessary (but not sufficient) condition for such competition to arise. As a result, it is imperative that the checklist items be fully implemented, tested, and proven capable of supporting the level of competition on which these consumer benefits depend. Pro forma satisfaction of checklist items without actual market experience by competitors may create the illusion of a market that is "open to competition" but closed to competitors. Such a level of checklist enforcement will ultimately harm consumers by forestalling the development of any real competition.

Q. PLEASE DESCRIBE THE TERM "EFFECTIVE COMPETITION."

A. Effective competition connotes an absence of significant monopoly power. Specifically, when effective competition is present, the economic benefits from public policy intervention in a market are more than offset by the economic costs of any regulatory efforts designed to mitigate the relatively small amounts of market imperfections that may exist. While economists envision a theoretical range of competition, spanning from perfect competition to pure monopoly, a benchmark for the determination of public policy attention is the presence or absence of effective competition. If effective competition is present, consumers are best served by the unimpeded operation of market forces.

Q. IS THERE A GENERALLY ACCEPTED METHODOLOGY IN ECONOMICS FOR EVALUATING THE INTENSITY OF COMPETITION IN A MARKET?

A. Yes. The intensity of competition can be gauged by the degree of monopoly (or market) power present. Where monopoly power is absent or de minimus, effective competition exists. Monopoly power, in turn, is the ability to control price and exclude competition. Fortunately, industrial organization economics provides a framework for determining whether a firm provides its services under conditions of significant monopoly power or, alternatively, faces effective competition. In particular, in most circumstances, one can assess whether a firm possesses significant monopoly power by examining three underlying structural determinants: (1) the elasticity (or responsiveness) of the supply of other firms, (2) market share, and (3) market demand characteristics.[5]

Q. IS MR. VARNER'S EVALUATION OF THE INTENSITY OF COMPETITION IN THE INTERLATA MARKET METHODOLOGICALLY SOUND?

A. No. Rather than applying the standard, widely-accepted economic criteria identified above, Mr. Varner simply makes unsupported assertions that this market is not performing competitively (see, for example, pages 60-61

of his direct testimony). Such an approach is neither objective nor analytical. It is a personal opinion, not economic analysis.

Q. IF WE APPLY THE TRADITIONAL ECONOMIC CRITERIA FOR ASSESSING THE INTENSITY OF COMPETITION TO THE INTERLATA MARKET, WHAT DOES THE EVIDENCE SHOW?

A. It shows unambiguously that this market is subject to fully effective competition. Consider each of the three criteria described above.[6]

First, with regard to the elasticity of competing firms' supply, the data reveal that the relative ease of entry into and expansion within the interLATA market result in a high supply elasticity. Exhibit DLK-3 depicts the number of long-distance firms competing in the interexchange market. As can be seen, roughly 500 firms are now vying for the patronage of long-distance customers nationwide.

Moreover, not only have firms entered the interexchange market, but they have also been aggressive in developing the capacity for future output expansions. Indeed, as seen in Exhibit DLK-4, both AT&T and its competitors have been very active in developing fiber optic transmission networks. The data exhibited here show that miles of fiber in place have increased in all categories every year since 1984. At the end of 1995,

AT&T had about 1.4 million miles of fiber in place, while other IXCs had about 1.3 million. Such capacity for future output expansions is important because capacity limitations facilitate monopolistic price increases on the part of incumbent firms. That is, any attempt by any incumbent interexchange carrier, say AT&T, to raise prices to supra-competitive levels would be aided if the capacity of its rival firms were limited. Alternatively, where the capacity of rival firms is abundant (and customers readily demonstrate a willingness to switch to alternative carriers), the ability of any firm contemplating a supracompetitive price increase is constrained.

In the case at hand, it is well known that the interexchange industry is rife with capacity. For instance, a recent study found that AT&T's competitors could readily absorb a significant percentage of AT&T's traffic immediately and within three months take roughly one-third of all of AT&T's traffic simply by utilizing spare switch ports and existing transport facilities.[7]

Importantly, the distribution of this transmission capacity in the interexchange industry is spread across a variety of carriers. Indeed, in Florida, there are at least 28 facilities-based interexchange carriers. This presence of alternative carriers with the capability to expand assures that

no interexchange firm has control over any bottleneck facilities that might aid in attempts to sustain supracompetitive prices.

Not only have firms been aggressive about their expansion of physical facilities in the interexchange industry, but they have also demonstrated in incontrovertible terms their willingness and desire to expand output. Exhibit DLK-5 depicts the growth of output of competitors to AT&T, such as MCI, in the post-divestiture period. As is readily apparent, these competitors collectively have exhibited a remarkable growth rate of roughly twenty percent per year between 1984 and 1996.

Finally, the breadth of interexchange service offerings in Florida also indicates that there is a high elasticity of supply by rival firms. Not only do a large number of firms offer long-distance service in this state and nearly 500 offer service nationwide, but this competition exists across virtually all product lines within the long-distance market. Every service offered by AT&T and MCI has competitive alternatives, whether MTS, Private Line, or high volume inbound services. Also, there has been an explosion of new service offerings by interexchange carriers in the post-divestiture period. This remarkable proliferation of services provides objective proof regarding the highly elastic nature of supply in the interexchange industry. In sum, the data unequivocally reveal that barriers

to entry and expansion are extremely low and, therefore, that the elasticity of competitive supply is quite high.

Q. DOES THE MARKET SHARE EVIDENCE ALSO INDICATE THE PRESENCE OF COMPETITION IN THE INTERLATA MARKET?

A. Yes. At the outset of the post-divestiture period, AT&T had a preponderance (over 90 percent) of interLATA traffic in the United States. As seen in Exhibit DLK-6, however, AT&T's minutes-of-use market share has dropped consistently during the past decade. At the same time, the output and breadth of competitors' service offerings has expanded dramatically. By 1996 (3rd quarter), AT&T's interstate minutes-of-use market share had fallen to 52.8 percent.[8]

Typically, the pattern and level of intrastate interLATA minutes-of-use market shares have followed closely the interstate market share statistics. The consistent and pronounced declines in AT&T's market share reveal a vulnerability of AT&T to competitive attacks. Importantly, this observed decline in market share has come about during a period in which the real price of long-distance services has fallen by over 50 percent. This decline in market share in the face of falling prices reveals a pronounced vulnerability of interexchange companies to competitive attacks. Clearly, in the event of any unwarranted attempt to raise prices above competitive

levels, the resulting market share loss would be devastating. Therefore, the market share evidence also provides unequivocal support for the conclusion that the interLATA market is subject to effective competition.

Q. DO DEMAND CHARACTERISTICS ALSO INDICATE THAT THE INTEREXCHANGE MARKET IS COMPETITIVE?

A. Yes. The demand characteristics of the interexchange market reinforce the competitive impact of the high elasticity of firm supply and the distribution of market shares in the interLATA market. Several considerations support this conclusion. First, overall market growth has been pronounced. Sales of interexchange services have increased dramatically since the divestiture. This large growth rate has had the effect of attracting new firms into the market and has mitigated the risk of failure for prospective new entrants.

Second, the distribution of demand across telecommunication customers has also contributed to the vulnerability of incumbent firms. Specifically, a large proportion of consumer demand for interexchange services is accounted for by a relatively small percentage of customers. That skewed distribution, together with a pronounced propensity of customers to switch long-distance carriers, makes the sales of any particular carrier subject to potentially large losses in the event of an anticompetitive price increase.

Third, consumer demand in long-distance services is characterized by an acute tendency to switch carriers. In 1994, some 27 million households switched long-distance carriers. By 1995, that number had swollen to over 42 million customers (representing some 19 percent of the interexchange carrier base).[9]

In the face of such a pronounced willingness and demonstrated ability of consumers to switch long-distance providers, the high elasticity of other firms' supply, and the existing distribution of market shares, it is virtually inconceivable that the long-distance market is characterized by anything other than effective competition. In short, buyers have too many choices, firms have too much capacity, and there is simply too little customer loyalty to any given carrier for any firm to possess monopoly power or exploit consumers of long-distance services in Florida.

Q. DOES ECONOMETRIC EVIDENCE EXIST TO SUPPORT THE CONCLUSION THAT THE INTEREXCHANGE MARKET IS COMPETITIVE?

A. Yes. At least two recent studies of the interexchange industry based on substantially different methodologies and different sources of data have both concluded that there is very little market power exhibited in the interexchange industry.

The first study, performed by a staff member of the Federal Trade Commission, makes use of two data sets -- a time series for interstate calling that covers the period from July 1986 through August 1991 and a pooled sample of monthly data that covers the 1988-1991 period for five states.[10] The study focuses on the small business and residential portion of the overall interexchange market. The results of the study support the conclusion that no firm in the interexchange marketplace holds significant monopoly power. Indeed, the study concludes that the potential economic welfare loss due to deviations of prices from those that would prevail under perfect competition are minuscule, ranging from 0.03 percent to 0.36 percent of industry revenues. (See Ward p.61)

The second study to provide an empirical assessment of market power in the interexchange industry is one conducted by Professors Simran Kahai, John W. Mayo, and me.[11] Based on quarterly observations on interstate calling volumes and tariffed rates for residential MTS service between the third quarter of 1984 and the fourth quarter of 1993, we simultaneously estimate the total market demand and the supply of AT&T's rivals while controlling for exogenous influences such as the price of carrier access and the percentage of lines converted to equal access. Based on these estimates and known values of AT&T's market share (alternatively on a capacity and minutes-of-use basis), it is possible to measure the degree of

market power held by AT&T. The results from this second econometric analysis also indicate that AT&T has very little market power and is therefore subject to effective competition. Given the relative size of AT&T in the interexchange market, this conclusion holds a fortiori for other long-distance carriers, such as MCI.

Q. HAS THE FCC MADE ANY FINDINGS CONCERNING COMPETITIVE CONDITIONS IN THE INTEREXCHANGE MARKET?

A. Yes. For several years, the FCC considered the issue of the status of competition in the interexchange market with an eye toward whether the market was sufficiently competitive to end price regulation and the dominant-carrier status of AT&T. As a consequence of that investigation, and in the presence of claims by the RBOCs that the market was insufficiently competitive to warrant a removal of price regulation of AT&T, the FCC found that the long-distance market was subject to a host of competitive forces and that, accordingly, AT&T should be reclassified as a "non-dominant" firm.[12]

Importantly, that finding was based upon a consideration of the same structural factors described above. Specifically, with regard to the issue of supply elasticity, the FCC notes that "AT&T's competitors have enough

readily available excess capacity to constrain AT&T's pricing behavior."[13] The FCC also points out that the source of the high supply elasticity derives not only from MCI and Sprint but from other smaller carriers as well. In particular, the Commission correctly noted that "[w]e find unpersuasive the arguments that interexchange carriers other than AT&T, MCI, and Sprint are too small to exert competitive pressure."[14]

On the issue of market demand characteristics, the FCC finds that "residential customers are highly demand-elastic and will switch to or from AT&T in order to obtain price reductions and desired features." The Commission also noted that "[t]he largest interexchange carriers continually promote various discount plans, which meet the needs of customers with different calling patterns (e.g., volume discounts, calling circles, postalized rates) and offer cash awards to entice residential consumers to switch carriers."[15]

In light of its consideration of supply elasticity, demand elasticity and the pronounced decline in AT&T's market share, the FCC concluded that "*The behavior of the market between 1984 and 1994 suggests intense rivalry among AT&T, MCI, and Sprint.*"[16]

Finally, the FCC has recently reaffirmed its position regarding the intensity of competition in the interLATA market. In its October 31, 1996 Order, the Commission states:

> "Thus we believe that market forces will generally insure that the rates, practices, and classifications are just, reasonable, and not unjustly or unreasonably discriminatory...We also reject the unsupported suggestion that the current levels of competition are inadequate to constrain AT&T's prices"[17]

Q. IS THERE ANY EVIDENCE OF COLLUSION AMONG INTEREXCHANGE CARRIERS?

A. No. In the face of the above overwhelming evidence of no unilateral market power and as a justification to permit reintegration by the RBOCs into the interLATA market, some RBOC witnesses have alleged that the interexchange market is currently subject to tacit collusion. For example, on page 61 of his testimony, Mr. Varner writes:

> "AT&T, MCI, Sprint and WorldCom carry the majority of the interLATA traffic but maintain a classic oligopoly. Prices move up in lock-step without regard to decreasing costs; profit margins are high and rising; and carriers target discounts at high-volume, price-sensitive customers while charging the majority of callers inflated basic rates."

I have evaluated this claim of non-competitive performance and found it to be unconvincing and unsupported by any credible evidence. Indeed, considerable evidence exists that refutes this claim.

The basic idea of tacit collusion is that, under certain well-specified conditions, rival firms in highly concentrated industries may gravitate toward the joint profit-maximizing (i.e., monopoly) price and output without actually entering into an explicit overt agreement to fix prices. As is widely recognized, however, whether this sort of behavior is likely to occur is highly dependent upon the specific characteristics of the market in question. For tacit collusion to arise, industry conditions must be favorable to the stable sort of "meeting of the minds" that must occur to sustain this highly coordinated market conduct.

Q. HAVE YOU EXAMINED THE INTERLATA MARKET TO DETERMINE WHETHER THESE INDUSTRY CONDITIONS ARE PRESENT?

A. Yes. A thorough examination of the structural characteristics of the interexchange market reveals that the industry is definitely <u>not</u> conducive to tacit collusion. In a recent article I co-authored with Professor John W. Mayo, I evaluated the structural and behavioral characteristics of the interexchange industry to determine the prospect for tacit collusion.

There, we describe at least seven structural factors that tend to impair the prospects for tacit collusion in this market:

[1] The market is characterized by low barriers to entry;

[2] The market is characterized by substantial spare capacity;

[3] The market shares of the largest firms are highly disparate;

[4] The market is characterized by a relatively complex price structure;

[5] The market is characterized by rapid product innovation;

[6] The market is characterized by a highly skewed distribution of demand; and

[7] The market is characterized by a very large number of competitors.

Attachment DLK-2 (pp. 15-18) describes in specific detail how each of these structural characteristics of the market act to deter the prospects for tacit collusion.

Additionally, an examination of the behavioral characteristics of the industry provides equally compelling evidence that tacit collusion is not present in the interexchange industry. Specifically, at least four aspects of observed conduct and performance in the interexchange marketplace are inconsistent with the claim that tacit collusion is occurring in this market:

[1] The downward trend in prices (both gross and net of access charges) over the past dozen years;

[2] AT&T's market share has exhibited marked instability over time;

[3] The presence of aggressive advertising and marketing campaigns of the various long-distance firms; and

[4] The consistent propensity and willingness of interexchange competitors to expand output.

Exhibit DLK-2 (pp. 18-20) explains in detail why each of these behavioral characteristics of the market are inconsistent with the conclusion that interexchange firms are engaged in tacit collusion.

Q. DO RECENT INCREASES IN THE BASIC TARIFFED RATES CHARGED BY AT&T, MCI, AND OTHERS TEND TO SUPPORT THE HYPOTHESIS OF TACIT COLLUSION IN INTERLATA TOLL MARKET?

A. No. Typical RBOC arguments characterize increases in tariffed rates which occur contemporaneously as tacit collusion. This characterization is incorrect on several grounds. First, firms in competition with one another operate in a common environment and therefore face similar changes in costs, demands, and the like. It would be incredible if the timing and directions of price changes were unrelated among firms.

Second, the widespread use of lower priced calling plans makes any analysis based on "standard" rates suspect. In fact, average rates per minute paid for long-distance services have continuously declined for many years.

Third, customers who use undiscounted tariffed rates are often very low volume users. Further, these basic schedule rates do not recover even direct costs for some low volume users.[18] Therefore, changes in some tariffs are probably best viewed as one facet of a broad movement in rate restructuring that predominantly leads to price reductions but may result in some prices (which were below costs under regulation) increasing.

Additionally, and most importantly, claims of tacit collusion by the long distance carriers are unbelievable when the scope of the alleged conspiracy is examined in detail. Since deregulation, large users have enjoyed huge reductions in per minute costs of long- distance services. Small users have enjoyed smaller reductions than large users but still pay substantially less. RBOC analysts typically focus on a narrow class of tariffs over a specific time period (usually, since 1989 or 1991). Accepting this approach, one is forced to conclude that, if the major IXCs collude, then they do so in a relatively small, unprofitable market segment while competing more intensely in larger, higher revenue venues. For example, in 1996, MCI

obtained less than 4% of its total revenues from residential callers using undiscounted calling plans. It would be simply nonsensical for a firm to collude on such a small portion of its overall business while competing aggressively on the remainder.

Q. THE RBOCS CLAIM THAT MOST CUSTOMERS DO NOT QUALIFY FOR DISCOUNT PLANS AND, CONSEQUENTLY, ARE NOT BENEFICIARIES OF INTEREXCHANGE COMPANY RIVALRY. IS THIS ALLEGATION CORRECT?

A. No. While the RBOCs have portrayed competition as only benefitting the larger long- distance customers, the vast majority of customers have benefitted from the intense rivalry among the long-distance carriers. Competition has led to an explosion of new services for residential and small business customers, improvement in the technical quality of service, improved customer service, and prices that more accurately reflect cost than at any other time in the post-divestiture era.

Moreover, it is a gross mischaracterization of the facts for the RBOCs to allege that residential and small business customers are not able to take advantage of the rivalry that exists for larger customers. Television, newspaper and other forms of solicitations are frequently targeted at exactly these customer groups. The result is that for any consumer willing

to engage in a modest amount of shopping, very attractive -- discounted -- rates are available for long-distance consumers even if they are not high volume customers.

Q. THE RBOCS HAVE ALSO CHARGED THAT THE LONG-DISTANCE MARKET EVIDENCES PRICE LEADERSHIP AND, THUS, THAT IT MUST NOT BE COMPETITIVE. HOW DO YOU RESPOND TO THIS CLAIM?

A. It is important to recognize at the outset that prices charged by rival firms routinely move together in competitive markets. Indeed, a high correlation among the prices charged by rivals is an indication that consumers view the services provided by these firms as close substitutes. Thus, the claim of "price leadership" requires far more specification if one is to take seriously the allegation that contemporaneous (or nearly contemporaneous) price changes signal less than competitive performance.

Economic analysis has revealed that price leadership is a routine practice in the U.S. economy and comes in several, generally innocuous, forms. For example, "barometric price leadership" occurs when a single firm that happens to be adept at reading market conditions calls out a price and other industry members routinely follow that price. This "price leadership" is thought to occur, for instance, in the automobile industry.

The "followership" behavior of some industry participants in the case of barometric price leadership, however, is not in any sense anticompetitive and will continue only so long as the "leader" firm's prices remain an accurate bellwether of market conditions. "Follower" firms will surely depart from the price called out by the "leader" should they see any profit opportunity from doing so.

Other types of price leadership are similarly innocuous.[19] It is for this reason that the United States Supreme Court established that a pattern of one firm calling out a price while others (in a temporal sense) follow that price is not evidence of anticompetitive behavior:

> the most that can be said as to this, is that many of its competitors have been accustomed, independently and as a matter of business expediency, to follow approximately the prices at which it has sold ... [its products]. ... *And the fact that competitors may see proper, in the exercise of their own judgment, to follow the prices of another manufacturer, does not establish any suppression of competition or show any sinister domination.* United States v. International Harvester Co., 274 U.S. 693, 708-709 (1927) (emphasis added).

Only where price leadership promotes collusive, monopolistic prices does this practice cause any anticompetitive concern. Yet, as I discussed earlier, numerous structural and behavioral factors in the interexchange industry indicate that collusive price leadership is not present in this industry.[20] Thus, the RBOCs' claims that the observed "price leadership" (really, just a correlation of price movements over time) is inconsistent with competitive market performance is completely unfounded.

Q. TAKEN TOGETHER, WHAT DOES THE ABOVE BODY OF EVIDENCE INDICATE ABOUT THE LEVEL OF COMPETITION IN THE INTERLATA MARKET?

A. Together, this body of evidence unequivocally demonstrates the presence of effective competition in this market. Consumers have benefitted tremendously from declining prices, expanded service offerings, and increased choices resulting from the intense rivalry that permeates that market. As a result, entry by the RBOCs is unlikely to improve performance significantly in this market. Indeed, if these firms possess substantial monopoly power in local exchange markets, such entry is likely to diminish competition.

III. COMPETITIVENESS OF LOCAL EXCHANGE MARKETS

Q. WHAT IS MR. VARNER'S POSITION REGARDING THE QUESTION OF THE COMPETITIVENESS OF LOCAL EXCHANGE MARKETS IN FLORIDA?

A. Mr. Varner apparently believes that the issue of the intensity of competition in local exchange markets is irrelevant to Section 271 deliberations. For example, on pages 31-32 of his testimony, Mr. Varner writes:

> "Thus it is clear that Congress debated and explicitly decided to exclude a specific level of local competition as being a requirement for interLATA entry."

And on page 33, he concludes that:

> "...BellSouth does not believe the level of local competition should be a consideration."

Q. DO YOU AGREE WITH MR. VARNER'S POSITION ON THIS ISSUE?

A. No. If Mr. Varner is offering strictly a legal opinion of the requirements of the Telecommunications Act, I am not qualified to respond. I am not an attorney and will not proffer a legal opinion on this issue.

As an economist, however, I must say that whether such reintegration is likely to have the beneficial effect claimed by Mr. Varner hinges crucially upon the intensity of competition in the affected local exchange markets.

Q. ARE LOCAL EXCHANGE MARKETS IN FLORIDA SUBJECT TO EFFECTIVE COMPETITION ACCORDING TO STANDARDS GENERALLY ACCEPTED IN ECONOMIC ANALYSIS?

A. No. These markets exhibit monopoly or near monopoly conditions. Application of the same criteria discussed above -- the elasticity of other firms' supply, market shares, and conditions of demand -- reveals that these local exchange markets are very far from effective competition. Further, and perversely, the speed at which effective competition can be expected to emerge in these markets depends critically upon the behavior of BellSouth and the response of regulatory authorities to this behavior.

Specifically, new firms entering local exchange markets in Florida will, in all likelihood, be dependent upon the cooperation of BellSouth and other local exchange companies in providing unbundled network elements, interconnection, and wholesale services for some time to come. BellSouth, in turn, has strong economic incentives to impede such entry to preserve its monopoly position. As a result, a heavy burden falls upon the regulatory agency to vigorously implement and enforce the provisions of

the Telecommunications Act to ensure, to the extent possible, that such entry-forestalling tactics do not succeed.

Q. WHAT ARE THE RELEVANT PRODUCTS AND SERVICES INCLUDED IN THE CATEGORY OF THE "LOCAL TELECOMMUNICATIONS MARKET"?

A. Although we often speak of the "local market," it is more accurate economically to view this portion of the industry as being segmented into (at least) three separate product markets. These markets are (1) intralata toll markets; (2) the market for carrier access; and (3) the market for local exchange services. The relevant barriers to entry and states of competition in these three markets differ in important respects, although none is presently subject to effective competition.

Q. HOW DO BARRIERS TO ENTRY AND COMPETITION VARY BETWEEN THESE MARKETS?

A. The technical requirements for competitive provision of these critical services vary significantly. The degree to which effective entry requires enforced cooperation by the incumbent local exchange carriers also varies. As a result, the current prospects for the emergence of competition in these markets also differs greatly. Those markets where nonregulatory entry barriers and the necessity of incumbent firm cooperation are lowest have

seen the greatest degree of competitive entry, although it is inaccurate to describe any of these markets as effectively competitive today. Nevertheless, these markets provide a useful object lesson in the importance of barriers to entry and strategic behavior by the incumbent local exchange carriers in hindering the emergence of effective competition in local telecommunications markets generally.

Q. WHAT IS THE CURRENT STATE OF COMPETITION IN THESE MARKETS?

A. The intraLATA toll market appears to be the most competitive of the three markets described above. This result is unsurprising given an economic evaluation of the entry conditions that characterize this market. It is probable that intraLATA toll markets could become effectively competitive in a very short time if: (1) equal access (i.e., intraLATA presubscription) were in place (which I understand has been implemented in BellSouth's territory); (2) access charges were reformed so that efficient pricing of access was allowed to prevail; and (3) the RBOCs could be prevented from exploiting their monopoly in local exchange markets to stifle competition in intraLATA toll. The current system is grossly slanted to the advantage of the incumbent carriers and has the effect of stifling competition and, thereby, limiting the competitive benefits realized by consumers.

Further, the incumbent providers of intraLATA toll have taken extensive steps to slow the emergence of effective competition in this market by introducing extended area service programs in response to threats of competitive entry. Strategic behavior of this sort is fully consistent with the view that incumbent local exchange companies are monopolies seeking to hinder entry by whatever means are available.

Q. WHAT IS THE STATE OF COMPETITION IN CARRIER ACCESS MARKETS IN FLORIDA?

A. The carrier access market is probably the second most competitive of the three local exchange markets. Nonetheless, while some limited entry by "competitive access providers" (CAPs) has occurred, this entry is wholly ineffective in several important respects. As a result, the market for carrier access remains highly concentrated and is subject to substantial market power.

The market for carrier access exhibits lower barriers to entry than do local exchange markets. CAPs may require connection from an interexchange company's point of presence (POP) to its local exchange consumers -- generally large volume business customers located in relatively dense urban areas. In some cases, however, they do not require interconnection with the local exchange company. In general, then, the extent of

interconnection required by CAPs is far less than that required by new entrants into the local exchange markets. Thus, for technical reasons, the CAPs are likely to be somewhat less vulnerable to strategic harm from ILEC's anticompetitive practices. Yet, any examination of this market on economic grounds strongly implies that effective competition has yet to emerge.

Q. WHAT EVIDENCE IS THERE THAT THE CAPS HAVE FAILED TO ESTABLISH EFFECTIVE COMPETITION IN THE MARKETS FOR CARRIER ACCESS IN FLORIDA?

A. There is substantial evidence of several kinds. First, the CAPs are quite specialized, almost "niche" providers. They target large companies, often located in large buildings. As a result, any competitive impact they may wield is felt by only a small portion of the overall access market. Second, CAPs overwhelmingly offer dedicated access services, which, again, limits their competitive impact. Third, the CAPs are relatively small and lack the capacity to offer mass marketed services that would provide most consumers a realistic alternative to the incumbent local exchange company.[21]

While the CAPs have provided some limited competition to the ILECs in special access services and private lines, it is important to remember that

few, if any, residential customers have any choice in access provision: they face monopoly supply conditions. It is thus highly inaccurate to describe the carrier access market as competitive.

Q. IS THE CAP EXPERIENCE RELEVANT IN DETERMINING THE LEVEL OF BARRIERS TO ENTRY IN THE CARRIER ACCESS AND OTHER MARKETS?

A. Yes. Three important points concerning the CAPs' experience are worth noting. First, access charges exceed the incremental costs of providing the access services many times over. Thus, the economic incentive to enter this market is strong. Second, despite the extraordinarily high level of these access charges and the longevity of this pricing distortion, CAP entry has been limited and has targeted only certain classes of users. Together, these two facts unambiguously demonstrate that significant nonregulatory barriers to entry exist in this market. And third, it is clear that these barriers apply a fortiori to the local exchange services market. That is, due to tremendous sunk costs and the need for interconnection, whatever barriers to entry exist in the access market are magnified in the local exchange market.

Q. DOES THE FACT THAT CARRIER ACCESS SERVICES ARE PRICED FAR ABOVE ECONOMIC COSTS CARRY ANY OTHER

IMPLICATIONS FOR THE EMERGENCE OF COMPETITION IN LOCAL EXCHANGE MARKETS?

A. Yes. Excessive prices for carrier access services are unwarranted on economic grounds. Such prices distort market outcomes in at least two dimensions. First, artificially high access charges raise the costs of providing long-distance services, thereby dampening consumption in that market. Moreover, these artificially inflated prices for toll services have, no doubt, discouraged new and innovative uses of the long-distance network over time. The economic (social welfare) costs of this distortion have been quite substantial.

Second, and perhaps more important, is the potential damage that excessive access charges can do to the emergence of competition in local exchange markets. These charges provide ILECs a source of excess revenues that can be used to subsidize anticompetitive practices of various sorts -- e.g., underpricing of intraLATA toll, extended area calling plans, and below-cost pricing of certain local exchange services. Cross-subsidization is the enemy of competition, and carrier access charges are currently providing the major source of the revenues required for such cross-subsidies. As a result, it is unlikely that effective competition will arise

throughout local exchange markets until these charges are lowered to cost.

Additionally, if the RBOCs are allowed to reenter the interLATA market while continuing to receive excess profits from the sale of access services, the potential for monopoly leveraging behavior will be expanded significantly. Therefore, access charge reform (i.e., lowering carrier access charges to their relevant economic costs) becomes an integral part of the overall process of promoting competition throughout telecommunications markets.

Q. ARE LOCAL EXCHANGE SERVICE MARKETS IN FLORIDA COMPETITIVE?

A. No, these markets are the least competitive of all. For residential consumers, choice is, for all practical purposes, nonexistent. Incumbent carrier market shares in local exchange services are generally well above monopoly levels for antitrust purposes. Indeed, in many local exchange markets, they are at or near 100 percent. Also, entry barriers are sufficiently high to allow monopolistic pricing without a substantial threat of response from potential competitors. Thus, the same criteria applied to the interLATA market earlier in this testimony clearly reveal the presence of substantial monopoly power in local exchange markets.

Q. WHY ARE LOCAL EXCHANGE SERVICE MARKETS SO HIGHLY CONCENTRATED?

A. There are several reasons. First, and most importantly, competitive entry into these markets requires an extremely high level of cooperation by BellSouth. The Telecommunications Act of 1996 and FCC orders explicitly recognize this state of affairs. The Act places extensive and detailed obligations on the ILECs in the areas of sales of unbundled network elements, their pricing and provision, determination of wholesale discounts, conditions of interconnection, etc.

These obligations were written into this law because it is abundantly clear that competition in local services can only arise if incumbents such as BellSouth can be forced to refrain from anticompetitive practices. Unfortunately, competition in these markets is not in the incumbents' economic interest. Unsurprisingly, they wish to maintain their monopoly status. Potential entrants, then, are placed in the unenviable position of being forced to rely upon the cooperation of another party who has every incentive to be uncooperative. And regulators are placed in the equally unenviable position of trying to enforce that cooperation.

Cost conditions and investment requirements also severely limit entry into local exchange services markets, particularly on a facilities-based basis. A

substantial portion of local exchange investment appears to represent sunk costs. Moreover, the dominant position that BellSouth holds interacts with these cost conditions and investment requirements to discourage entry. In particular, the high capital costs requirements of facilities-based entry (virtually all of which are sunk) become particularly prohibitive if BellSouth is expected to engage in post-entry strategic anticompetitive practices.

The role of sunk, or unrecoverable, costs attendant on entry in stifling competition is made worse by the promulgation of high "nonrecurring charges" (NRCs) for certain unbundled network elements. These charges, which should be based solely on the minimal, forward looking costs of provision, represent substantial sunk investments for new entrants. They are entirely sunk upon entry. As a result, they represent an entry barrier for firms attempting to enter through the purchase of unbundled network elements.

Finally, certain local exchange rates may incorporate subsidies (funded by excessive access charges). If they do, entry is further discouraged. The level and nature of these subsidies, however, are uncertain at this time.

Q. IF LOCAL EXCHANGE MARKETS IN FLORIDA ARE NOT EFFECTIVELY COMPETITIVE, ARE THEY "OPEN TO COMPETITION"?

A. The distinction between effective competition and "openness to competition" is driven primarily by the desire of some ILECs, such as BellSouth, to enter in-region interLATA toll markets while still retaining local exchange monopolies. While "open to competition" has no precise economic meaning, the closest related concepts are market "contestability" and low barriers to entry. A market with no sunk cost of entry, that further allows for very rapid entry and zero-cost exit, is called "contestable." In such a rarefied market, potential competition would play the same role as actual competition, limiting the exercise of market power even if the incumbent is a monopoly.

It is clear that local exchange markets in Florida are neither effectively competitive nor contestable. High entry barriers and significant sunk costs have severely limited entry in most important market segments. Retail-stage entry alone can never impose constraints on BellSouth remotely similar to those provided by effective competition or contestability. The experience of CAP entry, discussed above, is strong evidence of significant nonregulatory entry barriers.

If, on the other hand, by the term "open to competition" Mr. Varner simply means that regulatory barriers to entry have been removed and pro forma satisfaction of checklist items has been achieved, then the term is economically empty. Consumers cannot benefit from competition that is legally open but economically closed.

Thus, the argument that BellSouth has opened its markets to competition because it has satisfied the "competitive checklist" and should, therefore, be allowed to enter in-region interLATA toll markets while maintaining its local monopoly position is a purely legal claim - it has no economic content.

Q. CAN YOU SUMMARIZE YOUR DISCUSSION OF THE STATE OF COMPETITION IN LOCAL EXCHANGE TELECOMMUNICATIONS MARKETS?

A. Yes. Local telecommunications services are best viewed as segmented into (at least) three distinct product markets: intraLATA toll, carrier access, and local exchange services. While none of these markets is highly competitive, intraLATA toll is potentially competitive given equal access, access charge reforms and effective restraint of monopoly leveraging behavior. Carrier access and local exchange service markets are, however, quite concentrated, with BellSouth holding near monopoly

or monopoly positions. Moreover, these high levels of concentration are exacerbated by the presence of substantial barriers to entry. And, perversely, competition in the latter market requires cooperation by BellSouth via reasonable interconnection agreements, efficient pricing and provisioning of unbundled network elements, wholesale services, and the like. Until sufficient facilities-based entry occurs to erode the dominant position that BellSouth now holds, this firm will continue to possess substantial monopoly power in both the access and local exchange markets.

Therefore, regulation has a critical role to play in facilitating competitive entry into these important markets. In the absence of some regulatory mechanism to oversee the practices of BellSouth, one cannot credibly expect that the elimination of regulatory barriers to entry by itself will produce entry sufficient to render these markets effectively competitive. There are significant nonregulatory barriers to entry, as the dearth of CAP capacity in the face of exorbitant access fees shows. To fulfill the promise of competition in local exchange telecommunications markets, pro-competitive policies are and will continue to be required.

IV. THE LIKELY CONSEQUENCES OF BELLSOUTH REINTEGRATION AT THIS TIME

Q. WHAT CONCLUSIONS CAN YOU DRAW FROM THE PRECEDING SECTIONS OF YOUR TESTIMONY?

A. Two important conclusions flow from the analysis presented above:

[1] The interLATA market is subject to effective competition; and

[2] Local exchange markets are subject to substantial monopoly power.

These conclusions are strongly supported by both economic theory and empirical evidence.

Q. GIVEN THESE CONCLUSIONS, WHAT ARE THE LIKELY CONSEQUENCES OF ALLOWING BELLSOUTH TO REINTEGRATE INTO THE IN-REGION INTERLATA MARKET IN FLORIDA AT THIS TIME?

A. If RBOCs such as BellSouth are permitted to reintegrate into the interLATA market before effective competition (i.e., the absence of significant monopoly power) emerges in the local exchange market, incentives for monopoly leveraging emerge. In addition, once permitted into the interLATA market, BellSouth will cease even the minimal efforts that have been exhibited so far to treat interexchange sellers as customers whose interests they have no incentive to harm. Rather, BellSouth will

view interexchange firms as competitors that they seek to displace in the market.

The normal desire to displace competitors is an inherent and typically healthy effect of competition. If the RBOCs retain significant monopoly power, however, this incentive to displace rivals is perverted and is likely to manifest itself in an anticompetitive fashion. In this situation, then, reintegration by BellSouth prior to the eclipse of significant monopoly power in its local exchange markets will erode rather than promote competition in both the interLATA market and the local exchange market. Such an effect is clearly not in the interest of consumers.

In considering the dangers of the premature reintegration of BellSouth into the interLATA market, it is perhaps apt to recall the adage that "Those who forget history are destined to repeat it." The problems presented by having a firm with monopoly control of bottleneck facilities competing with unintegrated rivals in adjacent markets were thoroughly documented in the antitrust suits brought by both the Department of Justice and by MCI against the Bell System companies in the 1970s.[22]

While some RBOCs have claimed that local exchange is no longer subject to the significant monopoly power that gave rise to these abuses, a close

examination of the status of competition in local exchange markets today reveals otherwise. Moreover, the RBOCs have already demonstrated a propensity to engage in anticompetitive actions designed to maintain, extend, and exploit their significant monopoly power in the post-divestiture period. Such activities fall within the general description of monopoly leveraging.

Q. IS THERE ANY POST-DIVESTITURE EVIDENCE THAT MONOPOLY LEVERAGING IS LIKELY TO OCCUR IN THIS INDUSTRY?

A. Yes. Divestiture removed the incentive for the RBOCs to engage in monopoly leveraging behavior with respect to the interLATA market, and this judicial alteration of the industry's structure has greatly aided the emergence of healthy competition in that market. On subsequent occasions, however, the RBOCs have engaged in practices designed to forestall competition in areas where competitive rivalry has had the potential to develop. Examples of such behavior abound and are growing rapidly as competitive threats increase.

The case of Great Western Directories v. S. W. Bell Telephone is exemplary of the anticompetitive actions that are likely to arise with premature reintegration. This case arose when two independent publishers

of yellow pages (Great Western and Canyon), who were operating in Texas and Oklahoma, charged that Southwestern Bell (SWB) had orchestrated an affiliation-wide concerted action "to extend the SWB monopoly of the yellow pages market and to eliminate competition by raising the costs of doing business as an independent directory ..." Specifically, Great Western and Canyon charged that SWB had violated Section 2 of the Sherman Act by "abusing an essential facility and through market leveraging."

The jury in this case found that:

> [1] SWB had monopolized and attempted to monopolize the alleged relevant markets ... by denying reasonable access to an essential facility;
>
> [2] SWB monopolized the same alleged markets by leveraging monopoly power; and
>
> [3] SWB attempted to monopolize the alleged markets by increasing the price of the essential facility while at the same time substantially reducing [advertising] rates.[23]

This case of anticompetitive behavior on the part of SWB stems directly from the possession of significant monopoly power at one stage in the vertical structure of the industry. The underlying economics closely

parallel the situation of a prematurely reintegrated RBOC and should, therefore, give pause to any prudent policymaker who is contemplating the risks of anticompetitive behavior in the event of reintegration prior to the development of effective competition in local exchange markets.

In another case, Pacific Bell was ordered to open its intraLATA toll market to 10-XXX competition in California. In the wake of the California Commission's mandate to open this market to competition -- a step opposed by the RBOC -- Pacific refused to permit customers to avail themselves of an automatic routing feature that would have resulted in intraLATA traffic being directed to their new competitors. A challenge to this anticompetitive practice led to a preliminary injunction hearing. The California Public Utilities Commission concluded that "Pacific is attempting to maintain a monopoly in the intraLATA market by the means of such refusal to serve."[24]

Collectively, these and other actions like them demonstrate that the RBOCs are motivated and willing to engage in actions that promote their narrow economic interest over the broader "public interest."[25] While self-interested behavior is generally highly correlated with the broader social interest under competitive market conditions, the possession of and desire to retain significant monopoly power creates an incentive to engage in

actions that are in the profit maximizing self-interest of the firm but are clearly counter to the broader goal of effective competition.

RBOC claims that they possess neither the incentives nor the wherewithal to engage in anticompetitive practices if allowed to reintegrate at this time are transparent, misleading, and self-serving. Vertical integration by a regulated firm with significant monopoly power at one vertical stage creates strong economic incentives for the firm to engage in anticompetitive practices against its unintegrated rivals, and we have seen ample evidence that these incentives can be borne out in actions despite the presence of regulations designed to prevent them.

Q. YOU STATED ABOVE THAT PREMATURE REINTEGRATION BY THE RBOCS WOULD REDUCE THE INTENSITY OF COMPETITION NOT ONLY IN THE INTERLATA MARKET BUT IN THE LOCAL EXCHANGE MARKET AS WELL. CAN YOU EXPLAIN HOW THIS LATTER MARKET IS AFFECTED BY SUCH EARLY REINTEGRATION?

A. Yes. Under the terms of the divestiture agreement, the only incentive the RBOCs had to facilitate the emergence of effective competition within their local exchange markets was the promise of being allowed to reenter the (now competitive) long-distance market. In itself, that promise did not

provide much incentive. In effect, under Section VIII.C of the MFJ, the RBOCs were presented the following offer:

> If you will relinquish your monopoly over the local exchange market, you will be allowed to reenter the competitive interexchange market.

It is little wonder that that offer was not accepted. Abrogation of monopoly in return for permission to enter a competitive market is a distinctly bad deal.

Under the terms of the Telecommunications Act of 1996, that same basic offer remains in place, with one very important difference. Specifically, Sections 251 and 252 of the Act create policies designed to facilitate entry by interexchange carriers and others into local exchange markets on both a facilities-based and resale basis. As such entry unfolds, the RBOCs' new competitors will, for the first time since divestiture, be able to offer customers bundled service packages containing both local and long-distance services. It is widely believed that consumers will place considerable value on the convenience of having a single firm provide the full range of their telecommunications needs. Some preliminary empirical evidence suggests and many industry observers believe that firms that are unable or unwilling to offer service bundles including, at a minimum, both

local and long-distance calling will suffer a significant handicap in competing for customers' patronage in this new environment.[26]

As a result, successful entry into local exchange markets will greatly intensify the incentives for the RBOCs to reenter long distance so that they, too, can provide the bundled service offerings valued by consumers. In effect, the wilted and unappetizing carrot offered by Section VIII.C of the MFJ will be transformed into a large and powerful stick with the local exchange entry envisioned under the Act. With such entry, the RBOCs will feel considerable pressure to facilitate whatever level of competition is required under Section 271 to permit their own reintegration.

If that reintegration is allowed to proceed without first experiencing sufficient entry into local exchange markets, however, that incentive to facilitate competition will be lost. In fact, with reintegration, the RBOCs' incentive to maintain their monopoly positions in local exchange markets will be heightened as profitable opportunities to circumvent the constraints provided by regulation will be created thereby. Therefore, premature reintegration -- viz, reintegration that is allowed to occur before local exchange markets are subject to effective competition -- will jeopardize competition in both the long-distance and local exchange markets. Consumers will be doubly harmed if such reintegration is allowed to

occur. The benefits of competition will be denied or postponed in both markets.

V. OTHER ISSUES

Q. ON PAGE 63 OF HIS TESTIMONY, MR. VARNER ARGUES THAT ALLOWING BELLSOUTH TO ENTER THE IN-REGION INTERLATA MARKET WILL YIELD SUBSTANTIAL CONSUMER BENEFITS BY PERMITTING BUNDLED SERVICE OFFERINGS. DO YOU AGREE WITH THIS ARGUMENT?

A. No. On the contrary, the existence of a demand for bundled service by the public, if true, highlights an important asymmetry between IXCs integrating into the local market, and the local monopoly integrating into interLATA toll. If the ILEC becomes a long-distance provider while maintaining its local monopoly status, it automatically becomes the monopoly provider of the bundled service. To the extent it can, it then extracts the maximum amount of these bundle-created benefits from consumers through its packaged service pricing and other means.

In contrast, the IXCs are not monopolies in any market. As a result, entry by IXCs into local service will assure that consumers, rather than producers, receive the full benefits created by offering bundled services. If

these bundling benefits exist, then, they should be made available to consumers. Like any product, however, consumers will realize the full benefits only if the good is competitively provided, not offered by a monopoly.

Besides the very different consequences of bundled service provision by competitive firms and monopolies, another important asymmetry exists with regard to BellSouth entry into interLATA toll markets and IXC entry into local markets. Unlike local markets, the long-distance market exhibits full equal access and a very level playing field, benefitting entrants. In contrast, entry into many local markets confronts the potential competitor with a host of technical and operational difficulties. As a result of these asymmetries, it is absolutely crucial that local exchange competition precede RBOC in-region interLATA entry.

Q. AT PAGE 57 OF HIS TESTIMONY, MR. VARNER ARGUES THAT REGULATORY AND JUDICIAL MECHANISMS EXIST AND ARE ADEQUATE "...TO ENSURE THAT NO HARM RESULTS TO THE PUBLIC OR COMPETITION." ARE SUCH REGULATORY CONTROLS LIKELY TO SUCCESSFULLY RESOLVE CONCERNS ABOUT MONOPOLY LEVERAGING BY A REINTEGRATED BELLSOUTH?

A. No, they are not. If BellSouth were allowed, at this time, to reintegrate into inregion interLATA markets, circumstances quite similar (if not identical) to those associated with anticompetitive behavior in the predivestiture environment would arise again. History clearly reveals that regulation was incapable of preventing monopoly leveraging behavior in that environment. Further, entrepreneurial ingenuity can often find a way around regulatory initiatives aimed at moderating anticompetitive actions.

The structural separation imposed on the then integrated Bell System by the MFJ was, in large measure, a response to the extreme difficulty oversight authorities had in policing anticompetitive actions by Bell.[27] Actions by the Bell System prior to the MFJ ran the gamut from traditional leveraging strategies to outright refusals to deal. In his opinion, Judge Green noted that,

> "the testimony and documentary evidence adduced by the government demonstrate that the Bell System has violated antitrust laws in a number of ways over a lengthy period of time.[28]

Recent actions by some RBOCs raise similar concerns. A rather extensive discussion of such cases is offered by Professors Bernheim and Willig .[29]

Q. CAN REGULATORY MECHANISMS SUCH AS PRICE CAPS AND IMPUTATION TESTS PREVENT LEVERAGING?

A. No. They may combat leveraging, but they are unlikely to win the war. If regulatory mechanisms such as imputation tests worked perfectly, they could presumably prevent some limited forms of leveraging. The difficulty, though, is that, in practice, such procedures are far from perfect. As the economist Walter Oi observed, "...the imagination of the greedy entrepreneur outstrips the analytic ability of the economist."[30] The inability of regulation (or economists) to "keep up" with the ingenuity of the regulated firm is the defining rationale for the entire deregulatory movement. The history of telecommunications itself provides a stellar example. Yet, history also shows that competition can do what regulation cannot. Competition is, by far, the best regulator.

Q. AT PAGE 59 OF HIS TESTIMONY, MR. VARNER ARGUES THAT, BECAUSE BELLSOUTH IS SUBJECT TO PRICE-CAP REGULATION IN FLORIDA, IT "...WOULD THEREFORE NOT HAVE AN INCENTIVE TO IMPROPERLY ALLOCATE COSTS." IS THIS ARGUMENT ECONOMICALLY VALID?

A. This argument would only be valid if two necessary conditions were met. First, only if BellSouth were subjected to price-cap regulation in its purest form would the link between its maximum prices and its costs be broken.

That is, the price caps would have to be set once and never be readjusted to bring them back into alignment with costs.

That, however, is not how price caps actually work in practice. Observed price-cap plans frequently provide for periodic true-ups of the applicable caps to the company's costs. As a result, real world price caps tend to work much more like traditional rate-of-return regulation with a fixed regulatory lag. Consequently, contrary to Mr. Varner's assertion, incentives for strategic cost misallocations remain.

More importantly, even in the absence of periodic true-ups, pure price-cap regulation would still fail to eliminate incentives for cross-subsidization through cost misallocation in situations where the regulated firm faces the threat of competitive entry into some of its markets. That is, Mr. Varner's argument would hold only under a franchised, entry-protected monopoly. In an environment where public policy decisions are aimed at fostering emerging competition, the argument is invalid. Here, the regulated firm will have incentives to misallocate costs -- not to increase its rate base but, rather, to preserve its monopoly position. For both of these reasons, Mr. Varner's argument fails.

VII. SUMMARY OF TESTIMONY

Q. WOULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

A. Yes. In my opinion, reintegration by Bell South into the interLATA toll market in Florida at the present time is unwarranted and premature. It is unwarranted because the consumer benefits that the Company claims will flow from such reintegration are lacking. Specifically, the interLATA market is already subject to effective competition. As a result, the addition of another competitor, even one as large as BellSouth, is unlikely to alter performance in this market perceptibly.

Moreover, reintegration is premature, because, as is plainly evident from even a superficial examination of local exchange markets, BellSouth retains significant monopoly power in the provision of local exchange and access services. In fact, competition in the market for switched local exchange services in Florida is virtually nonexistent at the present time. Consequently, reintegration by this firm raises the specter of monopoly leveraging behavior, which will result in a lessening of competition in the long-distance market. Also, by allowing premature reintegration, any incentive that BellSouth might have to facilitate the growth of competition in its local exchange markets (or even to acquiesce to the growth of such competition) will be lost. As a result, competition in these latter markets will also be harmed by reintegration at this time. Accordingly, reintegration by BellSouth into the interLATA market is likely to harm

competition in both markets. Therefore, BellSouth's 271 application should be denied.

1. These firms had been excluded from that market under the terms of the settlement reached in the AT&T divestiture case. See United States v. American Tel. & Tel. Co., 552 F. Supp. 131 (D.D.C. 1982). Specifically, under Section VIII.C of the Modified Final Judgment issued in that case, the RBOCs were proscribed from reintegrating into interLATA long distance until they could demonstrate to the satisfaction of the Court that they would be unable to use their ownership of local exchange facilities for anticompetitive purposes in that market.

2. Reintegration into the provision of long-distance services outside the RBOC's certificated region is permitted immediately under the Act without any substantive preconditions.

3. In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, First Report and Order, at pp 218, 312-316 (August 8, 1996).

4. Apparently, Mr. Varner agrees that the state of competition in Florida's telecommunications market is relevant to this decision. On pages 3-4 of his testimony, he writes that

> "It is also important for the Commission to assess the current market conditions existing in Florida. This assessment will assist this Commission in consulting with the FCC as to whether BellSouth has met the requirements of Section 271(c)(1)(A)('Track A') or Section 271(c)(1)(B)('Track B')."

5. For a more detailed discussion of the analysis of market power, see William M. Landes and Richard Posner, "Market Power in Antitrust Cases," Harvard Law Review, March 1981; and David L. Kaserman and John W. Mayo, Government and Business: The Economics of Antitrust and Regulation, Dryden Press, 1995, Chapter 4.

6. For a more extensive application of these criteria to this market, see David L. Kaserman and John W. Mayo, "Competition and Asymmetric Regulation in Long Distance Telecommunications: An Assessment of the Evidence," CommLaw Conspectus, Vol. 4 (Winter 1996), pp. 1-26, which is attached to this testimony as Exhibit DLK-2.

7. T. L. Brand, et al, "An Updated Study of AT&T's Competitors' Capacity to Absorb Rapid Demand Growth," in Ex Parte Presentation in Support of AT&T's Motion for Reclassification as a Non-Dominant Carrier, in CC Docket. No. 79-252, at Att. B (April 24, 1995).

8. See Long-Distance Market Shares, Third Quarter 1996, Federal Communications Commission, Industry Analysis Division, Common Carrier Bureau, January 1997.

9. See B. Douglas Bernheim and Robert D. Willig, The Scope of Competition in Telecommunications, American Enterprise Institute, forthcoming. See, also, David L. Kaserman and John W. Mayo, "Competition and Asymmetric Regulation in Long-Distance Telecommunications: An Assessment of the Evidence," CommLaw Conspectus, Vol. 4 (Winter 1996), pp. 1-26, which is attached as Exhibit DLK-2.

10. See Michael Ward, "Measurements of Market Power in Long Distance Telecommunications," Federal Trade Commission, Bureau of Economics, Staff Report, 1995.

11. See Simran Kahai, David L. Kaserman and John W. Mayo, "Is the 'Dominant Firm' Dominant? An Empirical Analysis of AT&T's Market Power," Journal of Law and Economics, Volume 39, October 1996, pp. 499-51.

12. In the Matter of Motion of AT&T Corp. to be Reclassified as a Non-Dominant Carrier, CC Docket 95-427, Order, (adopted October 12, 1995).

13. Id. at ¶ 58.

14. Id. at ¶ 62.

15. Id. at ¶ 64.

16. Id. at ¶ 72 (emphasis added).

17. Policies and Rules Concerning the Interstate, Interexchange Market, CC Docket No. 96-61, Second Report and Order, FCC 96-424, pp 21, 22, October 31, 1996.

18. Ex Parte Presentation in Support of AT&T's Motion for Reclassification as a Non-Dominant Carrier, CC Docket No. 79-252, April 24, 1995.

19. See, e.g., the discussion of "low-cost price leadership" found in David L. Kaserman and John W. Mayo Government and Business: The Economics of Antitrust and Regulation, Dryden Press, 1995, pp. 199-200.

20. Indeed, given the numerous times that product innovations, marketing and promotional plans have been initiated by someone other than AT&T, it is not at all clear that AT&T is most accurately described as the industry "leader." Consider, for instance, the well-documented blow rendered to AT&T by the introduction of MCI's Friends and Family Program or, more recently, the introduction of Sprint Sense.

21. See Bernheim and Willig, supra, Note 9.

22. MCI Communications v. American Telephone and Telegraph Company, 708 F. 2d 1081 (1983); and United States v. American Tel. & Tel. Corp., 552 F. Supp. 131 (D.D.C. 1982), aff'd sub nom. Maryland v. United States, 460 U.S. 1001 (1983).

23. A judgment was entered consistent with this verdict, which has been affirmed by the U.S. Fifth Circuit. Great Western Directories v. S. W. Bell Telephone, 63 F.3d 1378 (5th Cir. 1995).

24. See MCI Telecommunications Corp. v. Pacific Bell, Decision No. 95-05-020 (1995 Cal. PUC LEXIS 458).

25. Additional examples of anticompetitive conduct on the part of the RBOCs are discussed by Douglas Bernheim and Robert D. Willig, supra, Note 9.

26. Using survey data from Japan, Timothy J. Tardiff, "Effects of Presubscription and Other Attributes on Long-Distance Carrier Choice," Information Economics and Policy, Vol. 7 (1995), pp. 353-366, presents evidence of a price advantage of approximately 14 percent resulting from the ability to bundle local and long-distance calling. Other services that potentially may be bundled with local and long distance include cellular, internet, and video services.

27. See Timothy J. Brennan, "Why Regulated Firms Should Be Kept Out of Unregulated Markets: Understanding the Divestiture in United States v. AT&T," Antitrust Bulletin, Vol. 34 (Fall 1987), pp. 741-791.

28. Judge Greene's Opinion, September 11, 1981, U.S. v. AT&T, CC No. 74-16-98, 524 F. Supp. 1336 at 1381.

29. Bernheim and Willig, supra, Note 9.

30. Walter Oi, "A Disneyland Dilemma: Two-Part Tariffs for a Mickey Mouse Monopoly," Quarterly Journal of Economics, February 1971, p. 77.

CHAIRMAN JOHNSON: Anything else?

MR. HATCH: I think that's it for me for the moment.

CHAIRMAN JOHNSON: Okay? And your next witness? I don't know how to pronounce Pfau.

MR. HATCH: AT&T calls Michael Pfau.

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(Transcript continues in sequence in Volume 20.)