

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY OF

JOSEPH GILLAN

ON BEHALF OF

AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.

And

MCI WORLDCOM, INC.

Docket No. 990649A-TP

December 10, 2001

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1 **Q. Please state your name, business address and occupation.**

2

3 A. My name is Joseph Gillan. My business address is P. O. Box 541038,
4 Orlando, Florida 32854. I am an economist with a consulting practice
5 specializing in telecommunications.

6

7 **Q. Please briefly outline your educational background and related**
8 **experience.**

9

10 A. I am a graduate of the University of Wyoming where I received B.A. and
11 M.A. degrees in economics. From 1980 to 1985, I was on the staff of the
12 Illinois Commerce Commission where I had responsibility for the policy
13 analysis of issues created by the emergence of competition in regulated
14 markets, in particular the telecommunications industry. While with the
15 Illinois Commission, I served on the staff subcommittee for the NARUC
16 Communications Committee and was appointed to the Research Advisory
17 Council overseeing the National Regulatory Research Institute.

18

19 In 1985, I left the Commission to join U.S. Switch, a venture firm
20 organized to develop interexchange access networks in partnership with
21 independent local telephone companies. At the end of 1986, I resigned my
22 position of Vice President-Marketing/Strategic Planning to begin a
23 consulting practice. Over the past twenty years, I have provided testimony

1 before more than 35 state commissions, five state legislatures, the
2 Commerce Committee of the United States Senate, and the Federal/State
3 Joint Board on Separations Reform. I currently serve on the Advisory
4 Council to New Mexico State University's Center for Regulation.

5
6 **Q. On whose behalf are you testifying?**

7
8 A. I am testifying on behalf of WorldCom, Inc. and AT&T Communications
9 of the Southern States, Inc. (the "ALECs").

10

11 **Q. What is the purpose of your testimony?**

12

13 A. The purpose of my testimony is to place the opposing recommendations of
14 the ALECs and BellSouth into a context that makes comparisons simpler
15 (and more relevant). Cost proceedings are unavoidably complex and
16 detailed, and it is easy to lose sight of the larger context. The purpose of
17 my testimony is to step back and describe the "forest," while other ALEC
18 witnesses address each of the specific "trees."

19

20 **Q. How important are UNE-rate levels to local competition?**

21

22 A. UNE rate levels are critically important to local competition, particularly
23 competition for the vast majority of residential and business customers

1 with conventional, analog telecommunications needs that are (given
2 existing technologies and capital markets) only likely to see competition
3 that relies on access to UNEs. It is important to bear in mind that
4 BellSouth's Florida exchange network is fundamentally an inherited
5 resource – this network is the cumulative product of more than 100 years
6 of protected investment, encouraged (in part) by its explicit subsidization
7 for most of the latter half of the past century. As a result, this remarkable
8 public-private network enjoys substantial economies of scale and scope,
9 and may still be a natural monopoly in many respects.

10

11 One of the core reasons that the Telecommunications Act requires that
12 incumbents (like BellSouth) offer UNEs is so that these inherited scale
13 and scope economies can be *shared* by all providers, rather than shielding
14 BellSouth from competition and entry. Without access to UNEs,
15 BellSouth's exclusive access to this network would provide it an
16 (probably) insurmountable advantage, thereby solidifying its dominance,
17 particularly in the core market of residential and smaller business
18 customers with basic telecommunications needs. It is no understatement
19 to say that the future of local competition is directly related to UNE rates,
20 for it is these rates that will determine whether other entrants are provided
21 access to this critical network resource equal to that which BellSouth
22 provides itself.

23

1 **Q. Is there a substantial difference between the rate proposals of the**
2 **ALECs and BellSouth?**

3

4 A. Yes. BellSouth's rates produce a statewide average cost (to serve the
5 average POTS user) of approximately \$25.07 per line, per month. In
6 contrast, the ALECs' proposed rates produce an average UNE cost of
7 \$13.99. The principal difference between the proposals (at least with
8 respect to those UNEs necessary to offer basic POTS arrangements) are
9 that the ALECs recommend the elimination of BellSouth's charges for
10 "daily usage information," and lower rates for the analog loop.

11

12 **Q. Have you done an analysis to judge the plausibility of BellSouth's**
13 **proposed UNE rates?**

14

15 A. Yes. To get a sense of whether BellSouth's claimed UNE costs are
16 reasonable, I "bracketed" their proposal with two comparisons. First, I
17 compared BellSouth's claimed UNE-cost of its local network to the
18 network-related costs that it actually reported for 2000. Second, I
19 compared these same UNE-costs to BellSouth's 2000 revenues to
20 determine whether even BellSouth could profitably operate if it were
21 required to obtain access to the network like any other ALEC.

22

1 **Q. How do BellSouth’s claimed UNE-costs compare to its reported costs**
2 **for 2000?**

3
4 A. As shown on Exhibit JPG-1, BellSouth’s claimed UNE-costs exceed its
5 reported network-related expenses (Plant Specific Operating Expense,
6 Plant Non-Specific Operating Expense, Corporate Operating Expense,
7 Depreciation and Amortization Expense) by more than \$284 million in
8 2000. Moreover, the analysis is conservative – that is, BellSouth’s
9 claimed UNE-costs are higher than its reported costs by an even larger
10 amount – because of two assumptions in the analysis.

11
12 First, the analysis assumes that 100% of BellSouth’s Corporate Operations
13 Expense is network-related. Obviously, not all (or, perhaps, even most) of
14 BellSouth’s Corporate Operations expenses are incurred in support of
15 network operations. Consequently, by attributing all of these expenses to
16 network operation, the analysis overstates the costs that BellSouth actually
17 incurred in 2000.

18
19 Second, the analysis estimates the total UNE-cost for switched services
20 only, while BellSouth’s incurred expense in support of both switched and
21 non-switched services in 2000. The portion of BellSouth’s 2000 reported
22 network expense is likely to be substantial – non-switched services
23 account for nearly 35% of BellSouth’s lines in Florida (ARMIS 43-08),

1 and are typically more difficult (and, therefore, more expensive) to
2 provision. The analysis in JPG-1 includes the cost of non-switched
3 services in BellSouth's reported expenses (but not its UNE-cost estimate),
4 thereby understating the extent to which BellSouth's claimed UNE-cost
5 levels exceed its actual reported costs.

6

7 **Q. How do BellSouth's claimed UNE costs compare to its annual**
8 **revenues?**

9

10 A. Also shown in Exhibit JPG-1 is an estimate of BellSouth's Florida
11 operating income, assuming that BellSouth's actual levels of customer,
12 marketing and corporate operations expense were unchanged, and its
13 network cost replaced by the cost to lease the needed number of UNE-Ps.
14 Because BellSouth would be leasing UNEs rather than owning its
15 network, the analysis does not include any expense for depreciation or
16 plant-related operating costs. Moreover, the analysis provides a
17 conservative estimate of the expenses that BellSouth would *actually* incur
18 if it attempted to compete leasing network elements from itself because
19 the analysis does not include the non-recurring cost to serve new lines or
20 migrate customers.

21

22 As shown in Exhibit JPG-1, BellSouth's "UNE-self" would have barely
23 covered its costs, producing a gross margin of only 9% (contrasted with

1 the 44% gross margin that BellSouth actually enjoyed in Florida in 2000).
2 Of course, a “real” entrant would have to offer reduced rates to win
3 customers from BellSouth, and would thus not even realize the razor-thin
4 margin estimated here. (I note that the ALECs’ proposed rates would
5 produce for BellSouth’s “UNE-self” a gross margin of 39%, still lower
6 than – but certainly closer to – the actual return that BellSouth enjoyed).

7

8 **Q. Are BellSouth’s UNE rates affecting local competition in Florida?**

9

10 A. Yes. Although Florida is the largest state in the BellSouth region -- and
11 should, therefore, be its most attractive market -- Florida trails other states
12 in competitive development. It is important to appreciate that Florida
13 must compete with these other states (as well as other states in the nation)
14 for competitive resources and attention. The more unattractive the
15 economics in Florida, the less likely carriers will introduce new services,
16 products and prices here.

17

18 Exhibit JPG-2 compares the state of UNE-based competition with other
19 states in the BellSouth region and nationally. At the end of last year, UNE
20 penetration in Florida was 2.1%, while in Georgia UNE penetration was
21 nearly 80% larger (3.7%). More recent data indicates that UNE
22 penetration in GA is continuing to increase, fueled largely by the growth
23 of UNE-P. Exhibit JPG-2 also contrasts competition in Florida to two

1 other urban States for which I have comparable data: Illinois and Texas.
2 As those comparisons show, Florida is trailing national leaders in the
3 development of local competition, and trailing other States in the
4 BellSouth region as well.

5
6 There is no question that the State of Florida has chosen competition as
7 the principal defense against BellSouth's market power. This goal,
8 however, can only become a reality if UNE-rates provide entrants a
9 meaningful opportunity to compete by accurately reflecting the underlying
10 cost of this local network. Nothing in my testimony is intended to suggest
11 that the Commission should establish UNE-rates without regard to
12 underlying costs – but where the Commission applies its judgment, it is
13 useful to consider its implication.

14

15 **Q. Does this conclude your testimony?**

16

17 **A. Yes.**

Claimed UNE Costs and Reported Expenses

Annual UNE Cost	
BellSouth Claimed UNE Cost per Line ¹	\$25.07
Number of Lines	6,850,656
BellSouth's Claimed Annual UNE Cost	\$2,061,141
BellSouth Network Expenses (ARMIS 2000)²	
Plant Specific ³	\$427,076
Plant Non-Specific	\$183,378
Depreciation and Amortization	\$881,894
Corporate Operations ⁴	\$284,244
BellSouth Reported Network Expense	\$1,776,592

BellSouth as UNE-Based ALEC – Switched Services

Revenues ⁵	\$3,040,745
Costs	
UNE Lease Cost	\$2,061,141
Marketing	\$145,716
Customer Services	\$275,164
Exec & Planning	\$36,993
General & Admin	\$247,243
Total Operating Expense	\$2,766,257
Comparing Net Income	
BellSouth UNE-Self (above)	\$274,488

¹ Based on average calling patterns reported by BellSouth in ARMIS 43-08, Table IV.

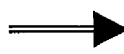
² Source: ARMIS 43-01, Table 1 (Regulated Expenses).

³ Plant Specific Expenses excludes costs associated with pay telephones, PBX and station apparatus (Account 6310).

⁴ Analysis assumes that 100% of Corporate Operations Expense is network-related. This assumption significantly overstates BellSouth's actual network-related costs by the amount of Corporate Operations Expenses that are unrelated to network operations.

⁵ Revenues include Basic Local Revenues, Extended Area Revenues, End User Revenues, Switched Access Revenues, IntraLATA Toll Revenues, State Access Revenues (ARMIS 43-03), as well as an estimate of BellSouth's Optional Feature Revenues derived from its 3rd Quarter 2000 earnings report.

**Relative UNE Penetration
 As of December 2001⁷**



BellSouth Region			
	UNE-L	UNE-P	Total
Georgia	1.9%	1.8%	3.7%
Tennessee	1.7%	0.6%	2.3%
North Carolina	1.4%	0.9%	2.3%
Florida	1.3%	0.7%	2.1%
Alabama	0.8%	1.0%	1.8%
South Carolina	0.8%	0.5%	1.2%
Kentucky	0.4%	0.8%	1.2%
Mississippi	0.4%	0.4%	0.8%
Louisiana	0.5%	0.4%	0.8%
Other Major States			
Illinois	3.9%	1.9%	5.8%
Texas	1.6%	13.5%	15.1%

UNE Growth: Georgia

	UNE-L	UNE-P	Total	Share
As of December 2000	80,698	78,068	158,766	3.7%
As of July 2001 ⁸	84,219	144,420	228,639	5.4%
	4.4%	85.0%	44.0%	

⁷ Source: FCC Form 477.

⁸ Source: Letter from Sean Lev to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket 01-277, October 10, 2001.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Rebuttal Testimony of Joseph Gillan in Docket 990649A-TP has been served on the following parties by Hand Delivery (*) and/or U. S. Mail this 10th day of December, 2001.

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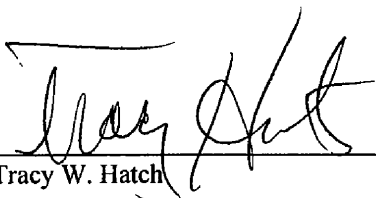
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