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October 23, 2002

VIA HAND DELIVERY

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Re: Docket Nos.: 020119-TP and 020578-TP

Dear Ms. Bayo:

On behalf of Florida Competitive Carriers Association, enclosed for filing and distribution are the original and 15 copies of the following:

- ▶ Testimony of Joseph Gillan on behalf of Florida Competitive Carriers Association
- ▶ Testimony and Exhibits of Danyelle Kennedy on behalf of the Florida Competitive Carriers Association

Please acknowledge receipt of the above on the extra copy and return the stamped copy to me. Thank you for your assistance.

Sincerely,
Joe McGlothlin
Joseph A. McGlothlin

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition for expedited review and cancellation
of BellSouth telecommunications, Inc.'s Key
Customer promotional tariffs and for investigation
of BellSouth's promotional pricing and marketing
practices, by Florida Digital Network, Inc.

Docket No.: 020119-TP

In Re: Petition for expedited review and cancellation
Of BellSouth Telecommunications, Inc.'s Key
Customer promotional tariffs by Florida Competitive
Carriers Association.

Docket No.: 020578-TP

DIRECT TESTIMONY OF JOSEPH GILLAN

ON BEHALF OF

FLORIDA COMPETITIVE CARRIERS ASSOCIATION

OCTOBER 23, 2002

DOCUMENT NUMBER DATE

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

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

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

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

12 In 1985, I left the Commission to join U.S. Switch, a venture firm organized to develop
13 interexchange access networks in partnership with independent local telephone
14 companies. At the end of 1986, I resigned my position of Vice
15 President-Marketing/Strategic Planning to begin a consulting practice. Over the past
16 twenty years, I have provided testimony before more than 35 state commissions, five
17 state legislatures, the Commerce Committee of the United States Senate, and the
18 Federal/State Joint Board on Separations Reform. I currently serve on the Advisory
19 Council to New Mexico State University's Center for Regulation.

20 **Q. On whose behalf are you testifying?**

21 A. I am testifying on behalf of the Florida Competitive Carriers Association (FCCA), an
22 advocacy group formed to promote competition broadly throughout Florida.

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

1 A. The purpose of my testimony is to explain the policy and economic considerations the
2 Florida Commission should consider when setting the terms for BellSouth promotional
3 offerings and “Winback” offerings. As a practical matter, local exchange competition is
4 in its infancy and BellSouth is in a position to leverage its inherited monopoly position to
5 frustrate the emergence of competition. Consequently, the Commission must establish a
6 framework that balances BellSouth’s desire to retain each and every customer with rules
7 and procedures that protect against anticompetitive and discriminatory behavior.

8 The policy of the State of Florida (as embodied in Florida Statutes) clearly recognizes the
9 unique problems created when competition is being introduced into a previously
10 monopoly market and recognizes that transitional rules will be needed that apply
11 differently to the incumbent than to entrants. For instance, Section 364.01(4)(d) requires
12 the Commission to “(p)romote competition by encouraging new entrants into
13 telecommunications markets and by allowing a transitional period in which new entrants
14 are subject to a lesser level of regulatory oversight than local exchange
15 telecommunications companies.” Moreover, Florida Statutes include a number of
16 provisions that prohibit cross-subsidization and discrimination to protect customers (and
17 competition) from the abuse that BellSouth’s market position makes possible. What is
18 lacking, however, are clear standards and procedures that translate the statutes’ directives
19 into meaningful protections that are simple to understand and administratively feasible to
20 enforce.

21 **Q. Please identify which sections of Chapter 364 that the Commission should translate**
22 **into clear standards and procedures to protect consumers?**

1 A. There are a number of statutory provisions that are intended to prevent BellSouth (or any
2 other incumbent) from abusing its monopoly position. For instance, the following
3 provisions clearly prohibit cross-subsidization:

4 364.051(5)(b) The commission shall have continuing regulatory oversight
5 of nonbasic services for purposes of ensuring resolution of service
6 complaints, preventing cross-subsidization of nonbasic services with
7 revenues from basic services, and ensuring that all providers are treated
8 fairly in the telecommunications market. The cost standard for
9 determining cross-subsidization is whether the total revenue from a
10 nonbasic service is less than the total long-run incremental cost of the
11 service. Total long-run incremental cost means service-specific volume
12 and nonvolume-sensitive costs.

13 364.051(5)(c) The price charged to a consumer for a nonbasic service
14 shall cover the direct costs of providing the service and shall, to the extent
15 a cost is not included in the direct cost, include as an imputed cost the
16 price charged by the company to competitors for any monopoly
17 component used by a competitor in the provision of its same or
18 functionally equivalent service.

19 As indicated earlier, however, there are no set procedures that translate these statutory
20 prohibitions into meaningful enforcement rules that would actually prevent BellSouth
21 from engaging in below-cost pricing.

22 **Q. What procedures do you recommend?**

1 A. First, the Commission should adopt an imputation test to apply to individual services and
2 promotions. A straight-forward imputation test that could apply to each individual
3 service would require that the recurring price charged any customer under a promotion
4 must meet or exceed the sum of:

- 5 a) The recurring Commission-established rate for each UNE used in the
6 provision of the service as an estimate of the direct network costs, plus
- 7 b) The Commission-established wholesale discount appropriate to the class
8 of service (business or residential) as an estimate of the direct retail-
9 related costs of the service.

10 In addition, the imputation test for the non-recurring charge for any individual service or
11 promotion should be that the non-recurring charge assessed the customer must exceed the
12 non-recurring charges associated with each of the UNEs that underlie the service in
13 question. For each proposed promotion or service arrangement, BellSouth should be
14 required to file an imputation comparison that is open for public review that includes the
15 above information. The Commission should reject any proposed promotion where there
16 is a reasonable expectation that the recurring and non-recurring charges of the promotion
17 or service do not satisfy the above requirement. The Commission should require
18 BellSouth to apply this standard to all customer configurations that reasonably can be
19 foreseen to be associated with the promotion. Further, BellSouth should be prohibited
20 from effectively circumventing the standard by allowing customers to apply separate
21 discounts which, operating together, would cause the discounted price to violate the
22 standard.

1 **Q. How does your recommended standard relate to the “Key Customer” promotions**
2 **that were the genesis of this proceeding?**

3 A. I have been informed that the January 2002 tariff has expired, and that the June 2002 Key
4 Customer tariff will have expired prior to the decision in this proceeding. Consequently,
5 the more important consideration is to have the appropriate standard in place going
6 forward, so that proposed promotions that do not comply with the standard and that
7 would have an anticompetitive effect on the local exchange market can be identified and
8 intercepted at an early point.

9 To illustrate the test that I recommend, however, I will use an analysis included in the
10 prefiled testimony of Network Telephone witness Danyelle Kennedy relating to the
11 January 2002 Key Customer tariff. Ms. Kennedy testifies that the discounted retail price
12 of a 4 line service under the Key Customer promotion was \$98.84, whereas Network
13 Telephone’s cost of securing UNEs (via the UNE-P platform) with which to provide the
14 same service was \$93.68. Using Network Telephone’s calculation of the UNE-P as an
15 estimate of the direct network-cost to provide the service, and applying the wholesale
16 discount applicable to business customers of 16.81%, the floor of the recurring price for
17 the 4 line service under the discounted promotion should be \$112.61. Based on this
18 calculation, BellSouth’s discounted price of the service of \$98.84 fell below the
19 applicable price floor by nearly \$15. (In her testimony Ms. Kennedy points out that she
20 used the UNE-P prices that were in effect prior to the September 27, 2002 order of the
21 Commission that reduced many recurring charges prospectively. This is the appropriate
22 UNE price to use in the comparison, because the discount being evaluated was also in
23 effect prior to the reduction.)

1 **Q. Would this “service-specific” imputation test be sufficient, in and of itself, to**
2 **implement the cross-subsidy prohibitions of Chapter 364?**

3 A. No, I do not believe that it would. In addition to the service specific test described above,
4 Section 364.051(5)(b) also prohibits cross-subsidization of the entire class of nonbasic
5 services (i.e., the commission shall have continuing regulatory oversight of nonbasic
6 services for purposes of ... preventing cross-subsidization of nonbasic services with
7 revenues from basic services). I believe that this provision requires that BellSouth
8 periodically demonstrate that the total revenues received from all nonbasic services cover
9 the total cost of providing such services, including costs that may not be easily
10 attributable to any individual service but which may be reasonably assigned to the class
11 overall.

12 **Q. How would you recommend that the Commission enforce this provision?**

13 A. I recommend that BellSouth be ordered to file a fully-allocated cost study that
14 comprehensively assigns costs and revenues between the basic and nonbasic service
15 categories. The Commission should order BellSouth to provide this study within 60 days
16 and provide for hearings to challenge the methodology and accuracy of the analysis. To
17 the extent that BellSouth incurs costs that it believes cannot be assigned to either basic or
18 nonbasic services, it should clearly identify the magnitude of such costs, explaining the
19 source of the costs and providing a detailed explanation as to why they cannot be
20 assigned with reasonable precision to either category. Once the Commission settles on
21 the basic methodology to test for cross-subsidy between basic and nonbasic services in
22 the aggregate, it should require that BellSouth periodically update the analysis to reflect
23 current cost and revenue conditions. I recommend that BellSouth update the analysis

1 annually, given the importance of establishing the appropriate oversight during this initial
2 phase of competitive development.

3 **Q. Are there other statutory provisions that require further definition to be given**
4 **meaningful effect?**

5 A. Yes. In addition to cross-subsidy concerns, provisions of Florida Statutes also attempt to
6 balance pricing flexibility enjoyed by BellSouth with restrictions on discrimination and
7 anticompetitive conduct. Section 364.051(5)(a) embodies this balance, noting that
8 (emphasis added):

9 Nothing contained in this section shall prevent the local exchange
10 telecommunications company from meeting offerings by any competitive
11 provider of the same, or functionally equivalent, nonbasic services in a
12 specific geographic market or to a specific customer by deaveraging the
13 price of any nonbasic service, packaging nonbasic services together or
14 with basic services, using volume discounts and term discounts, and
15 offering individual contracts. However, the local exchange
16 telecommunications company shall not engage in any anticompetitive act
17 or practice, nor unreasonably discriminate among similarly situated
18 customers.

19 The above provision clearly contemplates that the Commission will apply its judgment,
20 balancing BellSouth's ability to generally respond to competition with a counter-
21 balancing prohibition against anticompetitive acts, practices and offerings that
22 unreasonably discriminate among similarly situated customers.

1 **Q. Do you believe that the Commission should establish guidelines that better define**
2 **what constitutes an anticompetitive or discriminatory promotion?**

3 A. Yes. There is no question that local competition is at a critical juncture. The Legislature
4 fully understood (Section 364.01(3), emphasis added) that “ ...the transition from the
5 monopoly provision of local exchange service to the competitive provision thereof will
6 require appropriate regulatory oversight to protect consumers and provide for the
7 development of fair and effective competition.” The Commission’s role is not passive,
8 but active – it is clearly charged with helping create the end-point of effective
9 competition so that regulation will no longer be needed. Achieving the long-term goal of
10 less regulation requires transitional rules to assure that competition has a chance to get
11 established and become effective. BellSouth has a 100-year head start on its rivals and its
12 dominance will not diminish easily or quickly without oversight.

13 **Q. Do you believe that BellSouth should be permitted to discriminate between**
14 **similarly-situated customers?**

15 A. No. BellSouth should not be permitted to price in ways that similarly-situated customers
16 cannot equally avail themselves of an offer or promotion. Sections 364.08 and 364.09,
17 Florida Statutes, address this practice directly. These statutes specifically prohibit
18 BellSouth from offering discounts to one customer that it does not equally offer to all
19 other similarly-situated customers. The issue, obviously, concerns what is “similarly
20 situated.”

21 I recommend that the Commission prohibit BellSouth from discriminating between
22 customers *solely* because some customers may have chosen an alternative provider. If
23 competitors offer service generally to an area, then BellSouth’s competitive responses

1 should be available to the same customer segment, not only those customers that may
2 have *chosen* an alternative. I do not believe that Section 364.051(5)(a)'s reference to an
3 incumbent "meeting the offerings of a competitor" was intended to sanction competitive
4 responses to only those customers *choosing* the offerings of the competitor.
5 Consequently, the Commission should presumptively prohibit any BellSouth promotion
6 that is available only to customers of competitors as discriminating against similarly-
7 situated customers.

8 **Q. Should the Commission also issue guidelines that limit the duration of a contract-**
9 **based discount?**

10 A. Yes. There is no question that BellSouth's incentive is to offer customers contracts to
11 lock-in customers prior to competition developing. At this point in the market's
12 development, I recommend that the Commission limit BellSouth from offering contracts
13 for standard services (i.e., traditional single or multi-line POTs services provisioned as an
14 analog voice service) of more than 12 months. For more complex digital services (i.e.,
15 services based on DS-1 or above connectivity), contract terms of up to 3 years are
16 reasonable.

17 **Q. Should the Commission also adopt guidelines that apply to termination liability?**

18 A. Yes. There is clearly a distinction between termination provisions that might arise in a
19 competitive environment (i.e., those needed to compensate a provider for customer-
20 specific costs) and provisions adopted by a monopoly to punitively restrict customer
21 choice. The problem is not with understanding the incentive, however, the issue is
22 finding a useful proxy or rule that permits one approach without sanctioning the other.
23 Given current conditions, I recommend that the Commission adopt a presumption that

1 any termination penalty greater than 3 months' discount is unreasonable. It is important
2 to recognize that this presumption would not preclude BellSouth from recovering
3 legitimate service-initiation costs -- to the extent that BellSouth incurs customer-specific
4 service initiation costs greater than the 3-month rule, BellSouth would simply have to
5 recover those costs through cost-based non-recurring charges and/or in the first few
6 months of billing.

7 **Q. Do you have any other recommendations?**

8 A. Yes. BellSouth is in a unique position. It is the incumbent with an established
9 relationship with the entire market; it typically possesses proprietary information on the
10 customer; and as the owner of the exchange network, it frequently has proprietary
11 information on the entrant as well. Because of these unique responsibilities, the
12 Commission should adopt limited restrictions on Winback activities to enable
13 competition to develop.

14 I recommend that BellSouth should also not be allowed to actively market customers that
15 have switched to another carrier for at least 30 days after service has been completely
16 transferred. This "cooling off" period will allow the customer to at least have one billing
17 cycle's worth of experience with its new carrier before BellSouth tries to lure it back.
18 This marketing restriction should include both inside and outside sales people, as well as
19 customer service representatives.

20 **Q. Are any other states addressing Winback offerings by incumbents?**

21 A. Yes. The Texas PUC has proposed rules regarding Winback activities. The Texas PUC
22 opened rulemaking Project No. 25784 to develop appropriate Winback and retention
23 regulations for price-cap regulated ILECs. The proposed rule includes provisions that

1 would: 1) create a presumption that any discount offered by the ILEC only to a former
2 customer within 30 days of that customer changing service to an ALEC is anti-
3 competitive and is prohibited; 2) any discount offered by the ILEC only to a former
4 customer that exceeds 60 days in length or is greater than a 25% discount off of the
5 tariffed recurring charge is anticompetitive and prohibited; and 3) any ILEC discount that
6 is offered only to customers who have been contacted by an ALEC or customers who
7 state that they are considering changing all or part of their service to an ALEC is anti-
8 competitive and prohibited. In addition, the rule would not permit an ILEC to circumvent
9 these restrictions via customer specific contracts, which are generally permitted.

10 **Q. Does this conclude your direct testimony?**

11 **A. Yes.**

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a true and correct copy of the Direct Testimony of Joseph Gillan on Behalf of Florida Competitive Carriers Association has been furnished by (*) hand delivery, (**) emailed or by U. S. Mail on this 23rd day of October 2002 to the following:

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