BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of

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

PETITION FOR EXPEDITED REVIEW AND CANCELLATION OF BELLSOUTH TELECOMMUNICATIONS, INC.'S KEY CUSTOMER PROMOTIONAL TARIFFS BY FLORIDA COMPETITIVE CARRIERS ASSOCIATION — DOCKET NO. 020578-TP

PETITION FOR EXPEDITED REVIEW AND CANCELLATION OR SUSPENSION OF BELLSOUTH TELECOMMUNICATIONS, INC.'S KEY CUSTOMER TARIFF FILED 12/16/02 BY FLORIDA DIGITAL NETWORK, INC. / — DOCKET NO. 021252-TP

ELECTRIC VERSIONS OF THIS TRANSCRIPT ARE
A CONVENIENCE COPY ONLY AND ARE NOT
THE OFFICIAL TRANSCRIPT OF THE HEARING,
THE .PDF VERSION INCLUDES PREFILED TESTIMONY.

VOLUME 1

PAGES 1 THROUGH 141

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN LILA A. JABER
COMMISSIONER J. TERRY DEASON
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER CHARLES M. DAVIDSON
COMMISSIONER RUDOLPH "RUDY" BRADLEY

DATE: Wednesday, February 19, 2003

TIME: Commenced at 9:35 a.m.

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

REPORTED BY: LINDA BOLES, RPR
Official FPSC Reporter
(850) 413-6734

APPEARANCES:

NANCY B. WHITE, R. DOUGLASS LACKEY and MERIDITH E. MAYS, BellSouth Telecommunications, Inc., c/o Nancy Sims, 150 South Monroe Street, Suite 400, Tallahassee, Florida 32301, appearing on behalf of BellSouth Telecommunications, Inc.

MATTHEW J. FEIL, 390 North Orange Avenue, Suite 2000, Orlando, Florida 32801-1640, appearing on behalf of Florida Digital Network, Inc.

FELICIA R. BANKS and LINDA H. DODSON, FPSC General Counsel's Office, 2540 Shumard Oak Boulevard, Tallahassee, Florida 32399-0850, appearing on behalf of the Commission Staff.

I N D E X

WITNESSES

EXHIBITS

PROCEEDINGS

CHAIRMAN JABER: Good morning. Let's go ahead and start this hearing with counsel reading the notice.

MS. BANKS: Good morning, Commissioners. Pursuant to the notice issued February 5th, 2003, this time and place has been set for hearing in Docket Number 020119-TP, 020578-TP and 021252-TP.

CHAIRMAN JABER: Let's take appearances. We'll start on this side.

MS. WHITE: Nancy White, Meredith Mays and Doug Lackey for BellSouth Telecommunications.

MR. FEIL: Matthew Feil for Florida Digital Network.

MS. BANKS: And Felicia Banks and Linda Dodson on behalf of the Commission.

CHAIRMAN JABER: Thank you. Ms. Banks, I understand that there are some preliminary matters that you want to bring to our attention this morning.

MS. BANKS: That is, that is correct, Madam Chair.

The first item is notices of withdrawal that have been filed in this proceeding. On January 31st, 2003, FCCA filed a notice of withdrawal of its protest and complaint in this proceeding. In addition, FCCA withdrew as a party from this proceeding.

CHAIRMAN JABER: Do I -- I should probably for the record acknowledge their notice of withdrawal?

MS. BANKS: Yes, Madam Chair. I think that would be appropriate.

CHAIRMAN JABER: Okay. Well, it's hereby acknowledged.

MS. BANKS: On Monday, February the 17th, 2003, Time Warner, US LEC and XO filed separate notices of withdrawal as parties from this proceeding.

CHAIRMAN JABER: The notices of withdrawal filed by Time Warner, US LEC and XO Communications is acknowledged.

MS. BANKS: The next item staff would like to bring to your attention is the notice of intent to file request for confidential classification. The first is BellSouth's February 5th, 2003, filing of its notice of intent to request confidential classification of its responses to FDN's second set of interrogatories, numbers 33 through 50.

The second is FDN's notice of intent to request confidential classification for its supplemental response to BellSouth's interrogatory number 33. And that filing was made on February the 12th.

CHAIRMAN JABER: But in terms of using any of those interrogatories as exhibits, we need to go ahead and maintain the confidentiality?

MS. BANKS: That's my understanding pursuant to the rule, Commissioner.

CHAIRMAN JABER: Okay. And the official request for confidentiality needs to come in within how many days?

MS. BANKS: 21 days of the filing of the notice of intent.

CHAIRMAN JABER: Okay. Do you all understand that?

MS. WHITE: Yes, ma'am.

CHAIRMAN JABER: Okay.

MS. BANKS: The last thing, Madam Chair, is parties and staff have agreed to stipulate to the testimony of BellSouth witnesses Bigelow and Massey.

CHAIRMAN JABER: Right. And I've excused those witnesses. And at the right time if you'll just remind me to move their testimony into the record. We'll do it in order though.

MS. BANKS: And one last note, Madam Chair. Staff has been advised that due to the recent weather in the northeast, Dr. Taylor, who is a witness of BellSouth, will be delayed in arriving at this hearing. And it's our understanding that he should be here sometime between 10:00 and 11:00 this morning, arriving.

CHAIRMAN JABER: That's fine. That's fine. Anything else?

MS. BANKS: There's no additional preliminary matters. But at the appropriate time staff would like to go ahead and enter their stipulated exhibits.

CHAIRMAN JABER: Let's do that right now before opening remarks and before I swear in the witnesses.

MS. BANKS: Staff would like to note that parties have been provided with copies of the stipulated exhibits. And for purposes of expediency, we will not go into an itemized listing, but would just make composite references.

CHAIRMAN JABER: Sounds good. And you've given a copy to the court reporter?

MS. BANKS: That is correct, Madam Chair.

CHAIRMAN JABER: All right. Let's do it this way. Staff's exhibit stipulation 1 is identified as hearing Exhibit 1.

Staff's stipulation 2 is a confidential exhibit, and that will be identified as hearing Exhibit 2.

Staff's stipulation 3 is hearing Exhibit 3.

Staff's Exhibit 4 -- stip 4 is a confidential exhibit, and that's identified as hearing Exhibit 4.

Staff's stipulation 5 is identified as hearing Exhibit 5.

Are there any objections to those exhibits?

MR. FEIL: No, ma'am.

CHAIRMAN JABER: Hearing --

MS. BANKS: The only thing I would add, Madam Chair, is that these exhibits are composites.

CHAIRMAN JABER: Yes. Thank you. Those are composite hearing Exhibits 1 through 5. And seeing no objection, hearing Exhibits 1 through 5 are admitted into the record.

(Exhibits 1, 2, 3, 4 and 5 marked for identification and admitted into the record.)

Now, Ms. Banks, I understand that parties have ten minutes each to make opening statements.

MS. BANKS: That is my understanding, pursuant to the prehearing order, Madam Chair.

CHAIRMAN JABER: Okay. And that there's been a decision to take up direct and rebuttal at the same time this morning.

MS. BANKS: That's my understanding as well.

CHAIRMAN JABER: Okay. And do the parties intend to make opening remarks?

MR. FEIL: I do. Yes, ma'am.

MS. WHITE: Yes, ma'am.

CHAIRMAN JABER: Okay. Great. Then that's where we'll start. And, Mr. Feil, I'm assuming you want to go first?

MR. FEIL: If it pleases the Commission, yes, ma'am.

CHAIRMAN JABER: Go ahead.

MR. FEIL: With regard to going first, I did want to make one point of clarification. While I acknowledge by virtue of the order of witnesses and so forth that I have the, at least the burden of coming forward, I'm not conceding at this stage that I have the burden of proof on all the issues in the case. Anyway, I'd like to begin my opening.

BellSouth does not have market power. BellSouth does not have market power. BellSouth's witnesses are hoping that if they say that enough times, you'll believe it. They say it directly, they say it subtly. It's repeated like a hypnotic mantra or Orwellian propaganda. Incredibly though that's one of the cornerstones of BellSouth's case and it's preposterous. Even by Bell's own estimate, Bell has 70 percent of market share of business customers. The competitors are dozens and dozens of ALECs having one percent, two percent, half a percent, .03 percent and so on, yet BellSouth does not have market power.

The ALECs with those small market shares pay wholesale revenue to BellSouth, which replaces the retail revenue BellSouth no longer collects when an ALEC gains a customer, yet BellSouth does not have market power.

BellSouth is discounting rates by 40 percent for the ALEC customer base while increasing rates significantly for others, many without a lower price option, yet BellSouth does not have market power.

BellSouth has boasted that it regains two out of every three lines it loses to competitors. In Florida it's perhaps even better or worse, depending on how you look at it, yet BellSouth does not have market power.

BellSouth has locked up under Key Customer contracts

19 percent of the promotion-eligible market in less than nine months, the kind of share it took hundreds of ALECs years to get, yet BellSouth does not have market power.

This case began nearly a year ago when BellSouth began discounting rates by over 40 percent tariff -- off of tariffed business rates for customers located in hot wire centers. I say 40 percent because when you add to the 20 or 25 percent maximum discount the free hunting service that BellSouth throws on top of that, the effect is a 40 percent discount.

BellSouth selected hot wire centers because of perceived competitive presence in the hot wire centers, but they made the election without regard to whether that presence was UNE loop, UNE-P or resale. They also made the selection of hot wire centers without regard to whether the centers were priced as Zone 1 for wholesale UNE purposes or Zone 2. This is important throughout the case because Zone 2 prices are higher for ILEC purchases of UNEs.

While discounting rates by 40 percent to some customers, BellSouth was increasing rates to other customers, many without a price option through no fault of their own. A critical issue in this case concerns them. You're presented a situation of haves and have-nots; those customers who have discounts and those that do not. It's bad enough that the have-nots do not get a discount, but BellSouth takes more from the have-nots to give to the haves.

This Commission's statutory duty is not to protect the haves only. The public interest you've sworn to uphold is to protect the haves and the have-nots equally. And you're not to protect the haves for just a brief interlude. You're to protect the haves and the have-nots for the long haul.

Contrary to what you may hear, it is not FDN's position in this case that you should take something away from the haves and close the books. Rather, FDN's position is that the have-nots must not suffer or be worse off than before and all customers and all competitors must be treated fairly.

BellSouth has submitted no proof, no analysis in this case that the have-nots are in any way better off as a result of the discounts given to the haves.

Simply put, BellSouth is leveraging its monopoly power in some markets without ALEC market share on the backs of the have-nots.

You'll hear a lot of talk from BellSouth in this case about opportunity, that there's an opportunity for ALECs to enter BellSouth's markets, that there's an opportunity for BellSouth customers under Key Customer contracts to leave the contract early and go to ALEC service, that there's an opportunity for ALECs to resell BellSouth's promotions, that there's an opportunity for ALECs to compete with BellSouth Key Customer prices. But these so-called opportunities are hollow.

They're opportunities that exclude a view of reality. It's like saying you can walk into a room through a bolted door. There's an opportunity for you to go through the door, it just happens to be bolted, but the opportunity is there.

Let me address some of these claimed opportunities. The first, market entry. The 271 review that BellSouth recently went under didn't look at discount programs or the exercise of market power in any way. Further, new facility-based carriers aren't coming into Florida; existing ones are leaving. And third, there's no rush of ALECs heading into the non-hot wire centers where BellSouth's prices are going up. The ones in BellSouth hot wire centers are subjected to Bell's claimed regaining two out of three lines that it loses to competitors.

With regard to the resale of promotions, there's not one resold promotional line by an ALEC in all of Florida territory, not one. Resale is a dead business strategy, whether as an entry strategy or otherwise.

If you -- or when you have the opportunity to look at BellSouth's own data, you'll see that resale has been in deep decline for the last two years, such that there's hardly any left in the state. Resale erodes and deters facility-based growth. BellSouth has no answer to this argument. Indeed, BellSouth has argued that UNE-P is no better than resale, and UNE-P erodes and deters facilities-based competition.

Customers can leave BellSouth Key Customer contracts early. Very few, if any -- very few have left early. And it's too pricey for the ALECs to buy out those customers from their Key Customer contracts. The Key Customer contract doesn't say customers can split service between BellSouth and an ALEC so that they can have some of their service with the ALEC and some of their service with BellSouth. Even so, BellSouth asks for 271 relief so customers could have one-stop shopping and wouldn't have to have split services. The idea of a customer having some Key Customer lines with BellSouth and other lines with an ALEC is contrary to that justification.

ALECs can compete on price. As Mr. Gallagher will testify, ALECs need to price below BellSouth to gain customer share, but pricing below the Key Customer promotions places a price squeeze on the ALECs with BellSouth's wholesale UNE prices. This hits UNE-L providers like FDN particularly hard.

Indeed, the evidence will show that the Key Customer program has not impacted UNE-P and UNE loop providers alike. And there's more than one squeeze going on here than just a price squeeze. While on the one hand BellSouth has its hand on the throat of the UNE loop providers through these Key Customer contracts, BellSouth has the other hand on the throat of the UNE-P providers at the FCC, demanding that the FCC eliminate the UNE-P vehicle. And then on top of that, BellSouth has the nerve to suggest that UNE-P providers become UNE loop providers.

As things stand now, the competitive controls are in the hands of BellSouth. Bell turns up the promotions knob and gets 19 percent locked into the contracts in nine months.

If they don't want to look too greedy, perhaps they turn the knob down and they have less share for a little while, but still they have customers under contract. With termination liability as onerous as it is under the Key Customer type promotions, you can see a trend in the market such as ALEC stagnation that may not be to your liking and have no ability to influence a correction over that trend until it's too late. That is precisely why you need to loosen BellSouth's termination liability provisions now because it gives the market a chance to put the brakes on a trend of stagnating competition and further BellSouth's market dominance.

In sum, Commissioners, you should set the blueprint for competition in the competitive market for telecommunication services in Florida, not BellSouth. It is your duty to ensure full and fair competition to all customers.

One word in closing. We did try to settle this case. We tried very hard. Ms. Mays and I went back and forth over a period of weeks, but we couldn't settle the case. And one of the reasons is because FDN feels it has to have the need for a real opportunity to compete, not a false opportunity, and all we're asking for in this proceeding is a fair shot at competing. Thank you.

CHAIRMAN JABER: Thank you, Mr. Feil. Ms. White, who's making --

MS. WHITE: Yes, Chairman. Mr. Lackey will be making the opening statement for BellSouth.

CHAIRMAN JABER: Okay. Go ahead, Mr. Lackey.

MR. LACKEY: Good morning, Madam Chairman, Commissioners. My name is Doug Lackey, and I'm an attorney representing BellSouth in this proceeding.

The purpose of an opening statement obviously is to provide some context to the matters you're going to hear over the next day to day and a half, and to tell you a little bit about what the witnesses are going to tell you during that period. I'll try to describe a little bit about that in the next couple of minutes.

This case involves some promotional offerings that BellSouth has made that we call our Key Customer promotions. These promotions are available in specified wire centers to business customers who meet certain preestablished criteria. These offers are available to new customers and they're available to existing customers. At bottom what these offers do is they provide business customers a discount on the services that BellSouth provides to them.

We'll be offering the testimony of eight witnesses in this proceeding. Some of them are internal witnesses who are going to discuss the competitive landscape that we face, who are going to describe how these plans were created, how the wire centers were selected and how the discounts were calculated. In addition, we're going to have some external witnesses who are going to share with you their opinions about these plans, including the former chairman of the Federal Trade Commission and a renowned expert on antitrust matters.

Now what are these witnesses going to tell you? Well, first they're going to tell you that BellSouth faces competition in the business market every single day. We have competitors who are offering our customers and potential customers discounts of 20 percent, 30 percent, 40 percent and more. And this isn't just going to be my witnesses giving you their opinion. They've got advertisements, yellow page ads, bills and other indicators to indicate that that is real.

The next thing they're going to tell you is they're going to tell you that this competition has been successful. And they're going to tell you something that I believe you already know; they're going to tell you that in June of 2002 when these plans were in effect, that the ALECs served 26 percent of the business lines in the State of Florida. More important to BellSouth, at that same time the ALECs served more than 33 percent of the business lines in BellSouth's territory; more than a third of the business lines.

Now is this competition spread evenly throughout

BellSouth's territory? No. The ALECs, unlike BellSouth, don't have to serve every nook and cranny of their service territory in Florida, they don't have to serve every comer. They pick where they want to serve. They don't have to serve everywhere like we do. And so we have made these promotions available in certain wire centers.

And the way those wire centers were picked is through a formula that our witnesses can describe, but basically it was generated by the number of lines that had been lost and the speed with which the lines were lost in Florida. And in truth, a significant majority of the wire centers in Florida are subject to these plans because the losses have been so severe in Florida.

Now what do we expect the opposition to these plans to argue? Well, Mr. Gallagher, who is the only witness appearing in opposition to these plans, will testify that our offers are anticompetitive, they're discriminatory and, gee, they're just unfair.

We expect that Mr. Gallagher will claim that ALECs cannot survive were they to adjust prices to lower, levels lower than BellSouth's Key Customer rates. That's going to be their claim.

What do we expect the evidence to show? Well, I've told you the ALECs have taken 26 percent of the business lines in Florida. They've taken 33 percent of our lines when we've had plans like this one and its predecessors that have been going on since 2000.

We expect that the evidence will show, for instance, that from 2001 to 2002 the percentage of lines that the ALECs served increased from 16 percent to 26 percent. I'm taking this from, from the report you all made to the Legislature. These are not BellSouth numbers that I'm giving you and that our witnesses are going to give you. They came out of the report that you all compiled and sent to the Legislature.

Now while I expect that Mr. Gallagher is going to tell you that the ALECs can't compete, we think the evidence is going to show that the number of ALECs in this state has been growing. We expect the evidence is going to show with regard to FDN that their revenues have grown from $20 million to $42 million to almost $70 million in 2002. We expect that FDN, a company that's been around, I believe, since the middle of 1999, three and a half years, added its hundred-thousandth line late in 2002. These are the companies that can't compete with us.

Now, as I said, FDN is the only ALEC that's here. There were other ALECs here earlier in this proceeding and you heard about the ones who withdrew, including the ALEC association, the FCCA. Well, they're gone, and so we couldn't find out from them exactly how these promotions had affected them. But FDN is still here, and we look forward to

Mr. Gallagher explaining to you all exactly how these plans have affected him, not in theory, not with hypotheticals, but how have these plans affected him. How have they affected a company that has doubled and quadrupled its revenues while these plans were in effect and added a 100,000 lines been hurt by these plans? We look forward to hearing that. We think it's going to be right interesting.

We also expect Mr. Gallagher to offer evidence claiming that these plans are discriminatory. And his solution or his reason, I guess, for them being discriminatory is they're not available in every wire center and they're not available to every business customer.

Now we hope you all find it as curious as we do that a competitor of ours would want us to make the plan that they're complaining about available more widely than it is, but that's what they claim. We think we know why, and let me give you an example that we'll pursue with Mr. Gallagher.

Assume that BellSouth had 1,000 business customers and that FDN only wanted to compete for 100 of them located in a specific geographic area, and they wanted to compete by offering them a $20 discount. If BellSouth wanted to compete for those 100 customers, we wanted to try to match that offer, according to Mr. Gallagher and FDN, we'd have to offer that discount, in order to be nondiscriminatory, to the other 900 customers that FDN is not interested in. In order to compete for 100 customers, we'd have to give an $18,000 discount to customers who don't have FDN's offer available. I suggest that they're recommending that because anybody can apply the mathematics and see that it's practically infeasible to do such a thing.

Now we believe when this hearing is done you'll wonder why FDN, contrary to the normal rhetoric we hear, is taking a position that limits customer choice and limits competition.

The evidence will demonstrate that our Key Customer plans, while they've been in effect, have not stymied competition. We've lost a third of our lines while these things have been in place. The evidence is going to show that only 20 percent of the eligible BellSouth customers have taken this offer. Now that's probably an indictment of our marketing organization, but the truth of the matter, as Mr. Feil said, less than 20 percent of the people have taken this offer; people who are eligible for it. But this is the program that's killing the ALECs in Florida.

We believe that when this case is done and you've heard this evidence, that what you're going to do is you're going to encourage us to do more of this, that you're going to urge us to continue to compete. Otherwise, we'll simply stand by in the wings and let these people offer the best business customers their 20 and 30 and 40 percent discounts and we won't be able to respond to them, and that's not competition.

We look forward to presenting our evidence, and I thank you for your attention.

CHAIRMAN JABER: Thank you, Mr. Lackey.

Okay. We're at that stage, staff, where I can swear in witnesses?

MS. BANKS: Yes, Madam Chair.

CHAIRMAN JABER: Okay. I'll ask that the witnesses in the room stand, please.

(Witnesses collectively sworn.)

Thank you. And, Mr. Feil, I do believe your witness is the first witness.

MR. FEIL: Yes, ma'am. FDN calls Mr. Michael Gallagher to the stand.

CHAIRMAN JABER: Mr. Gallagher, speak into that microphone. Let's make sure it's working.

THE WITNESS: Hello.

MICHAEL P. GALLAGHER

was called as a witness on behalf of FLORIDA DIGITAL NETWORK, INC., and, having been duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR. FEIL:

Q Sir, could you please state your name and business address for the record.

A Michael Gallagher, 390 North Orange Avenue, Orlando, Florida.

Q And what is your occupation, Mr. Gallagher?

A I'm the CEO of Florida Digital Network.

Q Are you the same Michael Gallagher for whom prefiled direct and prefiled rebuttal testimony were filed in this proceeding?

A Yes.

Q And your prefiled direct testimony consists of 28 pages; is that right?

A Yes.

Q Okay. And your prefiled rebuttal testimony consists of 11 pages; is that correct?

A Yes.

Q Okay. Did you have attached to your direct testimony any exhibits?

A Yes.

MR. FEIL: Madam Chair, I'd like to ask that Mr. Gallagher's prefiled exhibits be identified. His prefiled direct exhibits are 1 through 4.

CHAIRMAN JABER: MPG-1 through MPG-4 are identified as hearing, composite hearing Exhibit 6.

(Exhibit 6 marked for identification.)

MR. FEIL: And, Madam Chair, for the record, there was a revision filed yesterday to MPG-1. Although the cover sheet and identifying marks indicate it was MPG-4, it's really

MPG-1. I have extra copies here, if the Commissioners or the court reporter need them. Copies were served on the parties.

CHAIRMAN JABER: I know I need a copy. I'm not sure -- yeah. We all need a copy, Mr. Feil. Thank you for bringing copies with you.

MS. MAYS: Madam Chair, when the time is appropriate, BellSouth has an objection to admitting the revision.

CHAIRMAN JABER: Okay. Thank you. We're just identifying the exhibits now.

BY MR. FEIL:

Q Okay. Mr. Gallagher, do you also have attached to your prefiled rebuttal testimony any exhibits?

A Yes.

MR. FEIL: Madam Chair, I'd ask that you identify Mr. Gallagher's prefiled rebuttal exhibit, which is MPG-5, as Exhibit 7.

CHAIRMAN JABER: MPG-5 is identified as hearing Exhibit 7.

(Exhibit 7 marked for identification.)

BY MR. FEIL:

Q And those were all of your exhibits, Mr. Gallagher?

A Yes.

Q Okay. Going -- moving first to your prefiled direct testimony, did you have any changes to the text of the testimony?

A Yes, I do.

Q Would you please provide those changes?

A Yes. There's three numbers that are slightly incorrect that I'd like to correct for the record.

On Page 11, Line 12, the number 72.66 should be replaced with 73.05. And on Page -- on the same page, Line 21, the number 101.97 should be replaced with 105.30.

CHAIRMAN JABER: Okay. Hang on a second. Page 21.

THE WITNESS: Yes.

CHAIRMAN JABER: Line what?

MR. FEIL: Excuse me. Page 11.

THE WITNESS: I'm sorry. Page 11, Line 21.

CHAIRMAN JABER: Thank you.

THE WITNESS: The 101.97 should be replaced with 105.30.

CHAIRMAN JABER: Thank you.

THE WITNESS: And the last one is on Page 12, Line 2. The 59.13 should be replaced with 60.72. That's 59.13 replaced by 60.72.

BY MR. FEIL:

Q And were those changes made to match your revised Exhibit MPG-1?

A Yes. It ties, ties out to the numbers in the exhibit.

Q If I asked you the same questions in your prefiled direct testimony again today, would your answers be the same other than those corrections?

A Yes.

Q With regard to your prefiled rebuttal testimony, do you have any changes to that?

A No.

Q So if I asked you the questions in your prefiled rebuttal testimony today, would your answers to them be the same?

A Yes.

MR. FEIL: Madam Chair, with that, I'd ask that Mr. Gallagher's prefiled direct and prefiled rebuttal be inserted into the record as though read.

CHAIRMAN JABER: The prefiled -- you have an objection to that exhibit?

MS. MAYS: The objection is to the exhibit that he has reflected the changes to. So based upon that, we'll --

CHAIRMAN JABER: Okay. Then let's go ahead and, and discuss that exhibit.

What's the exhibit number, Ms. Mays? Oh, MPG-4?

MR. FEIL: It says 4. It should be 1.

CHAIRMAN JABER: The 1? You have an objection related to MPG-1?

MS. MAYS: Yes, Madam Chair, I do.

CHAIRMAN JABER: And what's the objection?

MS. MAYS: There's a couple of objections, Madam Chair.

First of all, the exhibit has several changes. It's beyond mere corrections. We -- I have a copy, if, if the Commission would like, where I have highlighted all of the changes on it. There are changes on almost -- I believe they're on almost every page, and there are two additional pages. So this is more than mere corrections that was provided. We just got a copy hand-delivered yesterday that was originally attached to direct testimony. So the issue of having the substantive changes so late is a problem for BellSouth, and we object on that basis.

We would also just note as a matter of courtesy that this was filed with the Commission via overnight and, again, counsel did not attempt to hand-deliver or contact us to alert us to it. We simply got it late afternoon the day before the hearing, two additional changes -- two additional pages, excuse me, with much more additional information.

CHAIRMAN JABER: Well, let me make sure I understand your concern and objection before I let Mr. Feil respond, before I make a ruling.

The -- you're not asserting that the three changes to the numbers -- you're not asserting that the exhibit contains additional changes other than the three made by Mr. Feil. You're just --

MS. MAYS: That's -- I'm sorry, Madam Chair. I don't mean to interrupt. It does make additional changes beyond those three.

CHAIRMAN JABER: All right.

MS. MAYS: I've highlighted and, if Madam Chair would allow me to approach, I can provide --

CHAIRMAN JABER: That would help me. Yeah.

MS. MAYS: What Ms. White will provide us is I have gone through the exhibit and simply highlighted on each page where this is either additional information or a change. And just flipping through that, we believe the Commission will see that it's a substantially different document than was filed. In addition, there are two whole entire new pages. The original exhibit -- excuse me. The original exhibit was already replaced once and we had no problem with that. But this additional exhibit has two -- Pages 11 and 12, and before it only had ten pages.

CHAIRMAN JABER: Thank you. Mr. Feil, your response.

MR. FEIL: I would hope that the Commission would want the right numbers. All Mr. Gallagher was doing by his revisions, updating, changing the numbers to make them his opinion right on an exhibit that he's going to sponsor. The fallout of those changes, as reflected in Mr. Gallagher's testimony, the corrections he just made, are relatively minor.

CHAIRMAN JABER: What are the nature of the changes?

How did you -- why did you just discover that the exhibit needed to be modified?

MR. FEIL: We did not -- there were things -- actually, I believe there's a note on -- if you'd look at the, for example, on the exhibit on Page 2, there's a note to include nonrecurring charges, a SOMEC charge, features and usage. The note was not there before. Features and usage was there before. Nonrecurring charges were, and SOMEC charges were added. And, again, we felt the need to include those in order to reflect an accurate depiction of what Mr. Gallagher testifies.

With regard to the suggestion that this is some kind of last minute surprise, I did speak with Mary Rosarioani (phonetic) yesterday and mentioned to her that the exhibit was being filed, and she said, okay. And I received changes from BellSouth to some exhibits this morning and was provided some discovery yesterday afternoon myself, so.

COMMISSIONER JABER: Mr. Feil, I'm not sure you answered my question though.

Why were those changes just discovered? I mean, what is it about that note that you just realized yesterday you needed? That's the first question.

The second question relates to those additional pages, Pages 11 and 12.

MR. FEIL: Actually I didn't make a comparison of the pages. Hold on.

CHAIRMAN JABER: Okay. And, and let me be clear. I'm trying to figure out if those are clerical, you know, typo type changes or if they are substantive changes. And, and frankly, if they're substantive changes, you need to go ahead and tell me that.

MR. FEIL: Some of the changes are substantive. The note indicates -- the three-asterisk note indicates that SL-1/SL-2 NRCs were included. The impact of those changes is relatively minor. And if you'd wait one moment, I'm doing a comparison of the pages.

(Pause.)

There are two more pages. I don't mind if you tear them off. I wouldn't have an objection to it.

CHAIRMAN JABER: And those are Pages 11 and 12?

MR. FEIL: Yes, ma'am.

CHAIRMAN JABER: Okay. Now you gave us in Mr. Gallagher's summary of the exhibit and the testimony there were three changes to numbers. I'm going to make you go back and tell me about those changes. The first, the first one was on Page 11?

MR. FEIL: Yes, ma'am. Page 11, Line 12.

CHAIRMAN JABER: The number changed from 72.66 to 73.05.

MR. FEIL: Yes, ma'am.

CHAIRMAN JABER: Are you asserting that's a clerical type error?

MR. FEIL: No, ma'am. I'm suggesting that to reflect the correction to include -- actually, if I remember correctly, the other item that was changed, and I don't mean to be testifying on this, was the usage included into the, the numbers on the revised exhibit. So there were -- the changes are substantive, but they're corrections. The same with respect to the impact on Page 11, Line 21.

CHAIRMAN JABER: Okay. Help me understand why these substantive changes are corrections that were not discovered until yesterday. Was there outstanding discovery you received?

MR. FEIL: No, ma'am.

CHAIRMAN JABER: Okay. I'm going to sustain the objection and not allow these changes to be reflected in the testimony, and we're going to stick with the original exhibit.

BellSouth, be forewarned, I'm consistent in how I rule. So if you have objections that come from the FDN side that are similar, I suggest you take this warning.

MS. WHITE: Yes, ma'am.

CHAIRMAN JABER: Okay. All right. We're going to stick with the original exhibit Number --

MR. FEIL: Actually, Madam Chair, there was --

CHAIRMAN JABER: Go ahead.

MR. FEIL: The original was revised in, I believe, November, so I assume, from what Ms. Mays said, that that is what they're okay with going by.

CHAIRMAN JABER: Yeah. Give me a date for that exhibit so that the record is real clear.

MR. FEIL: It was mailed November 6th.

CHAIRMAN JABER: Okay. MPG-1 that was accepted November --

MR. FEIL: Actually would have been filed November 7th.

CHAIRMAN JABER: Filed November 7th, 2002, is the exhibit we will allow in testimony.

Now with that, Mr. Gallagher's prefiled direct testimony shall be inserted into the record as though read. Mr. Gallagher's prefiled rebuttal testimony shall be inserted into the record as though read.

Q. Please state your name and address.

A. My name is Michael P. Gallagher. My business address is 390 North Orange Avenue, Suite 2000, Orlando, Florida, 32801.

Q. Who do you work for?

A. I am Chief Executive Officer of Florida Digital Network, Inc. ("FDN").

Q. What are your responsibilities as CEO of FDN?

A. As CEO of FDN, I am ultimately responsible to the shareholders for all aspects of FDN's operations and performance. On a management level, FDN's President & Chief Operating Officer, Chief Financial Officer and General Counsel report directly to me; FDN's Engineering & Operations, Customer Service, and Sales Vice Presidents report to the President & COO, who is also in charge of FDN's Marketing and IS functions. I am involved in the day-to-day business dealings of the company and the decision-making on everything from marketing and sales strategies, product development, network architecture and deployment, financing, human resources, customer care, regulatory changes, etc.

Q. Please describe your education and your work experience in the telecommunications sector.

A. I received a B.S. Degree in Mathematics with a minor in Physics from Rollins College.

Prior to co-founding FDN in 1998, I served as Regional Vice President for Brooks Fiber Communications where I had overall responsibility for operations, engineering, finance and sales in the State of

Texas. Brooks Fiber Communications merged into WorldCom on January 31, 1998. Prior to holding the VP position at Brooks, I was president of Metro Access Networks (MAN), a second-generation CLEC in Texas founded in 1993. At MAN, I developed all business strategies, designed network architecture, secured contracts with the company's original customer base, and had overall responsibility for operations and performance. MAN merged into Brooks Fiber in March 1997. Prior to MAN, I worked for Intermedia Communications and Williams Telecommunications Group (WilTel) as sales representative securing contracts with large commercial customers.

Q. Have you previously testified in a regulatory proceeding before a state utility commission, the FCC or a hearing officer?

A. Yes. I have testified before this Commission in Docket No. 010098-TP (FDN's Arbitration case with BellSouth) and in Docket No. 990649A-TP (the 120-day portion of BellSouth's UNE cost case).

Q. What is the purpose of your testimony in this proceeding?

A. I will address FDN's concerns with BellSouth discount price programs generally and BellSouth's Key Customer programs in particular.

Q. Please briefly describe FDN's operations.

A. FDN is a facilities-based Florida CLEC. FDN is also an IXC, a data services provider (both dial-up and dedicated), and, through an affiliate, FDN offers ISP and other Internet services. FDN was founded in 1998 with the mission of offering packaged services (local, long distance and Internet) to small- and medium-sized businesses. FDN launched operations in Orlando in April 1999 and expanded to Fort Lauderdale in May 1999 and to Jacksonville in June 1999. A second round of expansion in West Palm Beach, Miami and the Tampa Bay area was completed in the first quarter of 2000.

FDN owns and operates Class 5 Nortel DMS-500 central office switches in Orlando, Tampa, Jacksonville, and Ft. Lauderdale. FDN's switches are connected by fiber optic cable owned or leased by FDN to nearby incumbent local exchange carrier (or "ILEC") tandem switches. FDN leases collocation cages or has virtual collocation space in over 100 ILEC wire centers. Remote switching equipment is installed at these collocation sites and from these sites FDN accesses ILEC UNE loops. Connectivity from the collocation sites to the central ILEC tandem switch is via T-1 circuits leased from the ILEC. FDN relies upon its rights under the federal Telecommunications Act of 1996 (the "Act") to obtain "last mile" access to Florida consumers through the purchase of unbundled network elements (UNEs) from ILECs such as BellSouth.

FDN uses BellSouth's TAG gateway for electronic ordering. Using systems and software FDN developed on its own, FDN accesses BellSouth customer service records ("CSRs") electronically, and FDN transmits virtually all of its local service requests ("LSRs") to Bell electronically. The vast majority of FDN's LSRs to BellSouth are for 2 wire voice grade UNE loops. Based on information from BellSouth, FDN believes that FDN is the largest procurer of UNE voice-grade loops in BellSouth territory in Florida. At the time this testimony is filed, FDN does not utilize either the resale or UNE-P service delivery methods in BellSouth territory.

Q. Several issues in this proceeding ask what criteria, if any, should be established to determine if a BellSouth promotional tariff offering is unfair, anticompetitive or discriminatory. What factors do you think the Commission should consider?

A. First, I think the Commission cannot lose sight of the dominant market power that BellSouth currently has in Florida. In other words, the Commission cannot ignore the fact that BellSouth still effectively enjoys monopoly status in its incumbent territory. Though the exact percentage of ALEC market share in BellSouth territory was the subject of significant debate in BellSouth's 271 case (Docket No. 960786-TP) and the Commission did not make any specific findings as to ALEC market share, I do not believe anyone can seriously dispute that BellSouth is by far the dominant provider for voice services in its incumbent territory and has commanding market share. Nor do I think it can be disputed that BellSouth has substantial market power by virtue of its market share and its position in the market.

As a general proposition, the Commission should never permit a dominant market provider like BellSouth to use its market power to dictate market products or prices to the detriment of competitors and consumers, particularly when competition is still in a vulnerable infancy, as is the case here in Florida. When competition for IXC services commenced on a broad scale, the FCC recognized the harm that could result from letting the dominant market provider, AT&T, dictate price to its lesser competitors. For example, AT&T was subject to penalties when it offered special off-tariff pricing only to customers receiving a competitive offer. The FCC recognized that the pricing strategies of a dominant market provider may stifle competition at the root level. When AT&T lost enough market share in the IXC market such that AT&T was no longer a dominant carrier, AT&T was permitted greater pricing flexibility. By this time an emerging and healthy competitive industry was in place and customers enjoyed lower prices and competitive choices.

Further, it is important that the Commission understand that this is an extremely geographic issue. Based on its collocation footprint assumes that it can serve about 60% of the states' business lines via UNE loop facilities. BellSouth is leveraging the geographic weakness in FDN's and other competitors' network topologies by lowering prices only in the "islands" of competition, while raising or maintaining monopoly type rates elsewhere. Competitors do not have the option of resale or UNE-P in these other areas due to the viability and pricing inversion issues I discuss later in this testimony.

ALECS like FDN compete with BellSouth largely on the basis of price. FDN, for example, generally offers business service rates that are 20% lower than BellSouth's, and a lower price to the customer is one of the primary selling points that attract small and medium sized business to FDN's service. In a healthy competitive environment, competitors should be able to respond to one another's prices. However, for the telecommunications market in BellSouth's incumbent territory in Florida, ALECs could not survive were they to adjust prices to levels lower than BellSouth's Key Customer rates. ALECs do not have market power in BellSouth territory, and an ALECs' ability to counter a BellSouth price discount is extremely limited if not impossible (depending on the level of those discounts), particularly under present circumstances.

With regard to BellSouth's market power, the Commission must also understand the impact of a small ALEC's losing customers versus BellSouth's losing customers. If BellSouth loses a 100 line customer, that loss does not have a meaningful impact on BellSouth because that customer represents an extremely small portion of its total business and, assuming the departing customer ports from BellSouth to an ALEC, BellSouth is likely to gain revenue from wholesale services the ALEC requires to serve that customer. By contrast, when a small ALEC loses a 100-line customer, it has a tremendous impact on the ALEC's bottom line. One customer can represent a significant portion of the ALEC's business. Once the customer is lost, retail revenue from that customer is lost and that revenue is not replaced with any wholesale revenue.

From a business model approach, there are other practical matters the Commission must put into perspective. An ALEC like FDN must pay

BellSouth an installation fee of well over 3 times the monthly charge just to move the customer from BellSouth to ALEC services. Plus the ALEC must incur its own customer acquisition costs. The ALEC must then pay a continuing monthly fee to BellSouth to provide services over BellSouth facilities. Upon completing a customer conversion, an ALEC has reduced the consumer's telecommunication costs and increased BellSouth wholesale revenues. However, if after the ALEC acquires a customer, BellSouth via the 2002 Key Customer Program descends upon the customer and offers a steep 40% discount from BellSouth's original rates, BellSouth may entice the customer to rejoin BellSouth. If BellSouth is successful, the ALEC has now lost a customer for which costs have been incurred (costs largely not recovered), causing significant financial harm to the ALEC. But the pain and irony continue in that BellSouth will bill the ALEC a fee equal to 1.5 times the monthly charge to disconnect the customer's service even though the ALEC submitted no order for and played no part in the disconnection.

ALECs provide a beneficial service to Florida's consumers by reducing the rates the consumers had been paying to BellSouth, and the ALECs enhance BellSouth operations via nonrecurring charges and continued monthly wholesale charges in the place of BellSouth's retail customer charges. And yet, for this service, ALECs have been made prey to BellSouth "promotions" whereby the ALEC is left without revenue or a customer, and instead is left with a bill from BellSouth and significant unrecovered costs.

So, at an ALEC specific level, the impact of BellSouth's discounts can be extremely harmful when an ALEC loses existing customers. Moreover, on a big-picture level, if the Commission permits BellSouth's price discounts to continue unimpeded, BellSouth can use its monopoly status to peg ALEC market share at whatever level it desires, when it desires, in the geography it desires, and retain indefinitely its dominant status.

Investors are being asked to put capital at risk in competitive telecommunications ventures in Florida knowing that BellSouth, with its monopoly market power, can offer discounted prices at or below its smaller competitors' prices and push the competitors out of the market entirely and/or cause the competitor's growth to stagnate. Investors in the competitive carrier space do not commit capital to resellers, but in facilities-based competitors, and these investors key on growth potential. Growth potential is clearly jeopardized by the promotional prices and conduct of BellSouth. Further, the capital markets will be indifferent toward a small telecommunications competitor which has experienced growth in the past when continued growth is subjected to the unabated promotions of a dominant carrier like BellSouth, when growth is not what it otherwise would have been but for such promotions and if the growth has come at the expense of other providers that have failed. Without real growth potential, there is no doubt that capital markets will not look favorably on investment in Florida's competitive telecommunications sector. BellSouth's promotions pose a chilling effect on ALEC investment.

Additionally, without strong competitors, there will be no effective competition in Florida, and Florida's consumers will never receive the promised benefits of competition. A dominant provider like BellSouth will be able to increase prices as soon as the competition is disabled, and the fact that BellSouth has already increased prices to its captive customers foreshadows what can happen for the rest. Further, it would be inherently unfair and anticompetitive were BellSouth to use higher prices from captive customers to cover the cost of lower prices to customers subject to competition.

It is not FDN's position that ALECs should be forever insulated from an ILEC price response. Rather, it is FDN's position that the public interest demands that ALECs at least be protected from the anticompetitive conduct of a provider with BellSouth's market power.

Q. Aside from BellSouth's market power, what other factors should be considered?

A. The Commission must also evaluate the amount of the BellSouth discounts, the availability of the discounts and the manner in which the discounts are offered.

The maximum discounts BellSouth has offered under its Key Customer tariffs, for example, amount to 40% off a normal BellSouth bill. Under a Key Customer tariff, BellSouth has offered a 25% discount off total billed revenue (including basic local service), plus a 100% additional discount off hunting (or rotary) service, which is a $10.00 per line feature that nearly every multi-line business requires. ALECs simply cannot beat discounts like this without placing their futures in peril.

To me, it is very telling that at a conference in Miami on September 10, 2002, Mr. Ronald Dykes, BellSouth's CFO, claimed that Bellsouth wins back two out of every three customers it loses. At rates no viable competitor can beat, his assertion seems understandable. BellSouth's proprietary response to FDN Interrogatory No. 15 confirms that few customer lines in the Key Customer programs have left for competitors.

Attached hereto as Exhibit _____ (MPG-1) are spreadsheets that illustrate several points I would like to make relative to the price - cost issues involved in this matter. For this exhibit, FDN selected five sample customer location scenarios, Miami, West Palm Beach, Port St. Lucie, Orlando and Tamarac for a hypothetical customer with three business lines and hunting on all three lines – fairly typical for a small business. The exhibit compares the retail prices under a standard Bell tariff arrangement, a BellSouth's Key Customer deal (the current June 2002 tariff), and a standard FDN offering. As the exhibit shows, BellSouth's Key Customer scenario offers the customer a lower monthly recurring bill in each of the five cases than the FDN standard offering. On paper only, FDN may be able to beat the BellSouth Key Customer price (excluding consideration for any early termination or other liabilities) if FDN offered Key Customer programs through resale, but resale is not a viable option and does not justify BellSouth's practices as I address later in this testimony.

The wholesale cost information shown on this same exhibit demonstrates a few other points. For purposes of illustration, I suggest that the Commission's approved UNE-P rates can be used as a surrogate for a portion of a facilities-based ALEC's overall network cost or, alternatively, one can look at it simply from the perspective of an ALEC that uses UNE-P as its means of delivering service. Since the market will demand that ALECs compete with BellSouth on price such that, in the case of Key Customer rates, an ALEC must offer rates at least, if not more than, 16.81% off the Key Customer rates (with 16.81% representing the resale discount). Accordingly, if an ALEC attempts to price at 16.81% below the Key Customer level, in the case of the three line Miami location customer, that discount would generate ALEC revenue of $73.77 to cover costs of $72.66. (Note that per the Commission's recent decision, the CO at issue was switched from a UNE Zone 1 to a Zone 2). In this and in the other examples, it should be understood that the cost shown is just a portion of the ALEC's total cost; it does not include other costs like ALEC overhead, cost of sales, recovery of BellSouth's nonrecurring charges, etc. For the three line West Palm Beach customer, pricing 16.81% below the Key Customer rate would produce the same results. For the three line Port St. Lucie customer, pricing 16.81% below the Key Customer price would generate revenue of $65.79 to cover costs of $101.97. (This wire center was recently shifted from a Zone 2 UNE to Zone 3.) In the cases of the Orlando and Tamarac customers, where currently the lowest BellSouth retail and UNE rates are available, pricing below the Key Customer price would generate revenue of $73.77 to cover costs of $59.13, or a margin of just under 20% -- not much better than the resale margin and not enough to cover an ALEC's cost and not enough to encourage new investment in ALECs. Thus, it is not just a question of the margins being too thin to promote facilities based competition, but in many cases there will be no margin at all.

Stressing the geography issue again, I note that while BellSouth's discounts are placing downward pressure on rates, the Commission's UNE rate structure places an upward pressure on costs. By recent Commission decisions (including Order No. PSC-02-1311-FOF-TP, issued September 27, 2002), there are very limited UNE Zone 1 access lines and Central Offices ("COs") and the vast majority of BellSouth's access lines and COs are in UNE Zones 2 and 3. Exhibit No. ____ (MPG-2) is a map illustrating the limited geography covered by Zone 1 COs. Zone 2 and 3 UNEs cost significantly more than UNEs in Zone 1, and that fact alone serves as a deterrent to ALECs contemplating geographic expansions into Zones 2 and 3. However, BellSouth's promotions in Zone 2 rate centers, for example, serve as an even greater deterrent.

Should an ALEC attempt to meet or beat the Key Customer prices where those prices are available, the ALEC's overall margins would mortally suffer. Significantly, there are over 120 Hot Wire Centers per the June 2002 Key Customer tariff, but there are only 38 UNE Zone 1 wire centers where lower UNE rates are available to the ALECs. Less than one-third of all of the

Hot Wire Centers are UNE Zone 1 wire centers, and only one Zone 1 wire center is not a Hot Wire Center. The UNE rate structure severely limits the ALECs' ability to have a price response to BellSouth's 40% discounts, let alone invest in Zone 2. FDN would again, as it did in the 120-day portion of Docket No. 990649A, encourage the Commission to change the UNE rate structure such that there are more Zone 1 wire centers, and I suggest that the Commission's doing so becomes even more critical if the Commission does not restrict BellSouth's discounts.

I think the Commission must also look to how BellSouth has structured its promotional program eligibility and how BellSouth has marketed those programs. In my opinion, because BellSouth has not made its discounts available to all customers in the business class, the discounts are, if not discriminatory, at least anticompetitive in the manner in which they are set up and marketed. If BellSouth wants to offer steep discounts and free hunting to customers, it should offer those discounts and free hunting to **every** customer in the business class in Florida, not just to those customers who are or may be ALEC customers. Also, BellSouth should alert all eligible customers of those offers in the same way so that BellSouth does not in practice manipulate the eligibility criteria.

The promotional programs BellSouth has offered, like the Key Customer programs, are at least ostensibly designed to differentiate eligibility on the basis of a competitive presence in the customer's serving wire center. Thus, the programs target current ALEC customers and prospective ALEC customers. A customer in the business class not served by a Hot Wire Center pays a higher rate for both basic and nonbasic services than the same customer in the same business class who is served by a Hot Wire Center. I believe this, in itself, is discriminatory, anticompetitive, or both, but more so when considered in the context of the other factors present in this case (such as Bell's market power and the level of the discounts). Not only do Florida's ALECs suffer from losing existing customers to BellSouth's discounts, but the discounts are available only to customers who could leave BellSouth for an ALEC, which negatively impacts the total pool of future customers to whom the ALECs can sell.

Further, even if the eligibility terms were not discriminatory or anticompetitive, nothing FDN has seen from BellSouth's discovery responses or elsewhere convinces FDN that BellSouth uses the same means, methods and materials to offer the Key Customer program to **ALL** eligible customers. Instead, BellSouth focuses its marketing efforts on ALEC eligible customers, not on BellSouth's own eligible customers. If BellSouth has a lower tariffed rate available, BellSouth should be required to truly "offer" the lower rate to anyone eligible, not just to those who have already shopped around. BellSouth is acting in the manner of a retail store that has a sale on a product but does not give you the sale price unless you affirmatively ask for the sale price. The Commission should not sanction this, and I believe that any disparate marketing of BellSouth promotions is discriminatory, anticompetitive or both, in effect.

Q. Do you have a specific recommendation as to how the Commission should incorporate the factors you've just addressed?

A. Yes. Subject to adjustment for future changes in UNE cost structure, FDN maintains that the Commission should issue an order or rule whereby until such time as BellSouth no longer has market power and ALECs have achieved meaningful market share in BellSouth territory -- and the Commission may want to consider 40% ALEC market share as a reasonable and simple measure reflecting a shift in market power -- BellSouth should be barred from offering direct or indirect discounts of more than 10% off total billed basic and nonbasic telecommunications services, including hunting and all features. Further, any discounts available must be offered to all customers in the same class. This should at least diminish the anticompetitive effects of BellSouth's promotional discounts.

Q. Do you have an opinion as to the termination liability provisions and the program and contract durations of BellSouth promotional tariffs?

A. I think there should be established criteria for evaluating these aspects of BellSouth promotions, but the Commission must first focus on the criteria I have already mentioned: market share, price/cost, and class-wide eligibility. In principle, I think more lenient criteria can be applied to evaluate the anticompetitive or discriminatory impacts stemming from termination liability or from program or contract duration if the key criteria are as I have proposed.

While termination liability provisions such as those in BellSouth's Key Customer tariffs (T-020035 and T-020595) may be acceptable for a company without dominant market power, when a company has BellSouth's monopolistic market power, such termination liability provisions represent an unacceptable anticompetitive practice. These termination liability provisions "lock-up" customers in the coffers of the dominant provider and deter customers from freely migrating even if they find a better provider. As I mentioned earlier, while BellSouth is the dominant player and individual ALECs hold insignificant market share, ALECs have much more to lose if a customer ports out than does BellSouth. BellSouth's intent to lock up as much of the market as possible for itself is illustrated in BellSouth's response to FDN's Interrogatory No. 30. There, BellSouth said any wire centers that were not "30% penetrated by contracts" were not removed from the January 2002 Key Customer list of Hot Wire Centers when the June 2002 list was filed.

The penalty a customer must pay to leave BellSouth's January Key Customer program increases over time since that penalty consists of the aggregate rebates the customer has received from BellSouth. The penalty a customer must pay to leave the June Key Customer program is a flat fee per month remaining on the contract, so that penalty is higher if the customer wishes to leave earlier in the term. For both tariffs, the customer also has to repay waived connection charges. But, whether early or late in the Key Customer contract term, once a customer is lured away from an ALEC back to BellSouth, the customer has a substantial financial disincentive from leaving BellSouth again, and, as noted above, very few have.

ALECs cannot realistically attempt to regain customers lost to a BellSouth Key Customer program. ALECs cannot beat the Key Customer rates and remain viable, and an ALEC that lost a customer to a BellSouth Key Customer program still has unrecovered costs from when BellSouth took the customer, so any ALEC efforts to try to regain the lost customer would involve significant and redundant costs ALECs would be remiss in spending.

It is interesting to note that in the case of the January 2002 Key Customer termination liability scheme, when BellSouth increases its rates, the amount of the customer's termination liability increases because the discounts the customer has to repay at termination are based on a percentage of the total bill. This scheme could actually incent BellSouth to raise prices, and the customers would have more to lose if they wanted to leave early.

My general view of program or contract duration issues is similar in that if a BellSouth promotion meets the market-focused recommendation I made above, for instance, no more than a 10% discount, the program discounts could be available until BellSouth is no longer dominant. However, BellSouth's practice of rolling over recent promotional programs and the prospect of its rolling over related customer contracts compounds the detrimental effects on competition that the promotions cause in the first place.

Q. Do you recommend any specific restrictions for the termination liability provisions of BellSouth promotions?

A. To remove the anticompetitive obstacles posed by the sorts of termination liability provisions in BellSouth's Key Customer programs, I recommend that where a customer leaves a BellSouth promotion early to port to a carrier serving the customer through UNEs, the customer's termination liability should not exceed BellSouth's retail line installation rates. Aside from competitive concerns, this also recognizes the benefit that BellSouth would receive on the wholesale side from the nonrecurring and recurring charges paid by the new carrier.

Q. Do you recommend any specific restrictions for the duration of promotions eligibility and associated contracts?

A. In the absence of the limits I recommended on the promotions themselves, I believe that the duration of the discounts should be no greater than 60 – 120 days, depending on the level of the discount. At the current levels offered in the Key Customer programs, I would say no more than 90 days should be permitted. BellSouth should not be permitted to provide the discounts again thereafter for another year. This would serve to mitigate the anticompetitive impacts I have mentioned above. I also think the Commission has to recognize that the anticompetitive effects and inequities of the programs will be exacerbated over time and difficult to adjust midstream. If competition levels stagnate or, worse yet, decrease, it could be problematic for the Commission to alter the terms and conditions of discounts after the fact. Further, the eligibility distinctions can be troublesome enough for customers that do not qualify, but if contract rollovers were permitted without limitation, a customer with a Key Customer discount, for example, could move in year 2 of his contract to a non-Hot Wire Center, among a host of ineligible customers, yet could still keep his discount through contract rollovers for an unreasonable period.

Q. Do you think that BellSouth's January 2002 Key Customer tariff and its June 2002 Key Customer tariffs are unfair, anticompetitive, or discriminatory?

A. Yes, I do, for all the reasons stated in this testimony and for the reasons set forth in FDN's petition initiating Docket No. 020119. Additionally, neither of those BellSouth tariffs meets the criteria I have suggested above.

Q. Do you have an opinion on how the Commission should evaluate whether the billing conditions of a BellSouth promotion or the geographic targeting of a promotion are unfair, anticompetitive or discriminatory?

A. As I stated earlier, I think that the way BellSouth has structured its promotions is discriminatory, anticompetitive or both. The Key Customer promotions, for example, which discount basic and nonbasic services, have not been available to all customers in the business class, and BellSouth has not offered the discounts to all eligible customers using the same means, methods and materials. This notwithstanding, I believe that BellSouth should not be permitted to manipulate availability so as to run afoul of some other basic principles of fairness. I believe that any permitted discounts must be narrowly designed to meet competitors' offerings in specific geographies. Thus, for example, if the Commission permits BellSouth to offer a discount of nonbasic services in a geographic area (such as an area served by Hot Wire Center) to meet the specific offering of a competitor, the Commission should not permit the BellSouth discount to apply to different locations of the same business entity regardless of geography (such as areas outside Hot Wire Center locations) unless competitors can also make the same multi-location offer. Even so, other businesses located outside the Hot Wire Centers will claim discrimination.

Q. Do you think the Commission should apply any criteria it establishes in this case to BellSouth affiliates?

A. To the extent that an affiliate offer discounts, rebates or awards of any kind that apply to basic or nonbasic telecommunications services, yes.

Q. Under what terms and conditions should BellSouth promotional offerings be available for ALEC resale?

A. The terms and conditions should be consistent with the FCC's established rules and regulations. One of the FCC's requirements is that the terms and conditions for resale be reasonable.

I want to briefly address a few matters with respect to terms for reselling BellSouth's promotions. First, in a discovery response (FDN Interrogatory No. 25), BellSouth stated that, at present, the bills it will send to

ALECs reselling existing Key Customer promotions will not reflect the Key Customer discounts; but rather, the ALECs will have to calculate those discounts on their own and then apply to BellSouth for credits. I do not think that a system of mandatory and recurring credit requests is a reasonable way of billing a customer, and such a scheme would be unduly burdensome on the ALECs. If BellSouth anticipated ALECs' reselling these promotions, I would think that it would already have the systems in place to properly bill ALECs for reselling the promotions.

Also, in discovery responses (e.g. FDN Interrogatory No. 24), BellSouth indicates that if a customer to whom an ALEC resells a BellSouth promotion leaves the ALEC service before the end of a promotion contact term, BellSouth will charge the ALEC (not the end user) the entire termination liability. I believe that if the termination liability is unfair, anticompetitive or discriminatory to begin with, it would be even more so when resold such that the ALEC was responsible for those charges. Further, at least in cases where the departing customer goes back to BellSouth, I believe it is unreasonable to require the ALEC to pay BellSouth the termination liability and then for BellSouth to get the customer too. The Commission must question how resale conditions work relative to the nonrecurring charges (at the outset and at termination) in any case.

Q. What do you believe is the impact of the resale of BellSouth promotions?

A. Putting it bluntly, as long as the Commission permits BellSouth to continue providing discounts like the Key Customer programs, ALECs have a choice of becoming nonviable by trying to beat BellSouth's promotional prices or becoming nonviable by reselling those discounts. The resale "option" is not a vehicle for ALECs to mitigate the effects of BellSouth's anticompetitive practices; rather, like the promotions themselves, it is a plan for dissembling facilities-based competition.

Any opportunity ALECs have to resell BellSouth promotional prices is an empty consolation. Resale does not serve to avoid the harm ALECs suffer from BellSouth promotions, nor does it remedy BellSouth's conduct. The resale business has been for sometime now widely considered a non-viable, unfinanciable venture, and many ALECs like FDN do not generally resell services because of resale's inadequate margins -- margins that do not change when reselling a promotion. Even BellSouth admits that no Florida ALEC has resold to a customer with a BellSouth Key Customer contract (FDN Interrogatory No. 28). If resale terms and conditions were reasonable and resale were a viable competitive option, one must ask why this would be the case.

BellSouth has advocated that the Commission and the FCC promote facilities-based competition. Judging from an early October 2002 speech given by FCC Chairman Powell, the FCC seems to agree with BellSouth's sentiments for encouraging facilities-based competition. Chairman Powell said:

Economic recovery means building business that can expand employment opportunities for our Nation's citizens.

It means bringing real competitive choice to consumers and enhancing consumer welfare through differentiated products and services and differentiated pricing packages.

It means, in short, investment in facilities. For only through facilities-based competition can an entity offer true product and pricing differentiation for consumers.

Only through facilities-based competition will corporate spending on equipment thrive.

Only through facilities-based competition can a competitor lessen its dependency on an intransigent incumbent, who if committed to frustrate entry has a thousand ways to do so in small, imperceptible ways.

Only through facilities-based competition can an entity bypass the incumbent completely and force the incumbent to innovate to offset lost wholesale revenues.

> Only through facilities-based competition can our Nation attain greater network redundancies for security purposes and national emergencies.

.

Further, in an October 17, 2002, letter to Florida' congressional delegation and FCC Chairman Powell, this Commission stated:

> In the long term, facilities-based competition is the best way to provide maximum benefit to consumers. However, we recognize and we hope others recognize that in order to spur long term investment and commitment it is necessary to provide a stable, reasonably predictable legal and regulatory framework under which investors and service providers can operate with confidence.

Resale of ILEC promotional rates by ALECs will naturally promote erosion of facilities-based competition. As demand for resold promotional prices grows, demand for facilities-based services declines. Facilities-based ALECs cannot beat BellSouth's Key Customer discounts and remain viable, and ALECs and their investors should not then be given the signal to abandon existing facilities capacity and/or abandon possible facilities expansions just to compete with BellSouth as a reseller. This is totally at odds with the public interest (the facilities-based competition BellSouth itself has espoused) and totally at odds with Chairman Powell's and this Commission's stated intentions. Besides, neither fairness nor common sense could require a competitor to change its business model to a nonviable one (resale) just to evade anticompetitive conduct. The resale "option" is nothing more than another way of BellSouth's forcing its will on the market, and the Commission must reject BellSouth's promotions as anticompetitive and against the public interest.

Q. What marketing restrictions should be placed on BellSouth relative to promotions?

A. There should be adequate assurances in place so that BellSouth abides by existing CPNI and wholesale information restrictions. For example, no BellSouth retail employee or agent should have any access to wholesale information, such as an ALECs request for CSR information of submission and status of local service orders ("LSRs"). Further, the Commission should forbid BellSouth from using in-bound customer calls as a vehicle for retention efforts when the customer requests account activity predicate to a carrier change, including the following activities: steps necessary to reconfigure BellSouth's tied xDSL services and (until there is a suitable vehicle for ALECs to address pending service orders) steps for clearing pending service orders or problems with CSRs.

The customer has no choice but to go to BellSouth to initiate these identified types of account activities, and there is no accepted vehicle for ALECs to carry out such activities for the customer. For example, only the customer can have xDSL service moved off the billed-to number ("BTN" also know as the main or lead number) to another working number on the account. BellSouth's wholesale unit considers such matters a basis for clarifying or delaying LSRs submitted by ALECs. While a clarification to the LSR on the wholesale side may be understandable, BellSouth's rules or procedures should not be set up so ALECs basically have to deliver a porting customer right to the doorstep of BellSouth's retail side for a possible retention/winback sale. BellSouth's tying xDSL to voice service is anticompetitive to begin with, so requiring the customer to be subjected to a BellSouth retention/winback sale when the customer must go to BellSouth to minimize any xDSL port-related service problems is just as unfair and anticompetitive. The rationale relative to pending service orders is much the same. The ALEC should not be required to deliver a porting customer to BellSouth's retail group to clear a pending service order only to have the customer subjected to a retention/winback sale.

Additionally, I note that where an ALEC is voluntarily or involuntarily exiting a market, BellSouth should not be able to take advantage of its unique position as the underlying carrier to offer discounts to customers facing disconnection before the customers could have enough opportunity to fully evaluate other carrier options. A customer of a departing ALEC may be "under the gun" of disconnection or may be placed in the service of BellSouth by default as of a date certain if the customer does not select another carrier. The customer may be notified of such by BellSouth or by the departing carrier. In cases where BellSouth notifies the customers of a disconnection date or where BellSouth is listed as the default carrier on a notice, BellSouth has an inherent marketing advantage because the customers will likely turn to BellSouth for assistance. In cases where the exiting carrier notifies the customer of its departure and BellSouth is not a default carrier, BellSouth still has an inherent marketing advantage in that it already has subscriber information for all customers in an area that disconnected from BellSouth and can target market its discounts that way. ALECs who wish to compete for the business of the customers of the departing ALEC do not have either of these advantages. Therefore, if the Commission permits BellSouth to continue to offer Key Customer type discounts, the Commission should level the competitive playing field by directing BellSouth not to offer such discounts to customers of a departing ALEC until 30 days after the date that those customers are subject to disconnection or rolling over to BellSouth as a default carrier. This should permit the customers to evaluate offerings of other ALECs interested in their business.

Q. Are you aware of what some other state Commissions have done relative to ILEC promotions, retention and winback programs?

A. FDN made a public records request to the PSC staff asking for information that the staff had gathered regarding other state commissions' activities on the subject of promotions, retention and winbacks. One commission that has addressed the substance of promotional discounts was the Missouri PSC. Relying principally on the market power rationale I suggest above, the Missouri PSC suspended Southwestern Bell's winback tariffs. A copy of the Missouri PSC's December 21, 2201, suspension order is attached hereto as Exhibit ___ (MPG-3). Although the order speaks for itself, I note that the Missouri PSC reasoned that although ALECs had captured 22% of the business market and that the market was open to competition for 271 purposes, that 22% market share was divided among 66 ALECs and Southwestern Bell still was the dominant provider and the promotions would endanger competition. The Missouri PSC acknowledged that customers benefited temporarily from the lower winback rates, but determined it had the duty to look beyond this and to protect the viability of the overall market.

Similarly, the Texas PUC approved its staff's recommendation to move forward with rulemaking on winback/retention promotions largely on the rationale that ILECs continue to possess significant market power and can use winback/retention programs to keep competition sufficiently weak so that ILEC prices can be maintained or raised without significant consequence. An excerpt of the public record materials FDN obtained from staff regarding the Texas PUC's decision is attached hereto and marked Exhibit ___ (MPG-4).

Q. Does that conclude your direct testimony?

A. Yes.

Q. Please state your name and address.

A. My name is Michael P. Gallagher. My business address is Florida Digital Network, 390 North Orange Avenue, Suite 2000, Orlando, Florida, 32801.

Q. Are you the same Michael Gallagher that provided direct testimony in this case?

A. Yes.

Q. What is the purpose of your rebuttal testimony?

My rebuttal testimony will cover several, mostly thematic, points regarding competition and competitors, discrimination, termination liability and resale. I preface my rebuttal testimony, however, with this general comment. I think that much of the controversy surrounding this case could have been avoided had BellSouth simply offered across-the-board rate decreases to all of its customers rather than geographically targeting such unreasonably steep decreases (up to 40% off with hunting) to just a group of customers in specific geographies where Florida's developing competitors operate. With across-the-board decreases, all of BellSouth's customers could share in the benefits of competition and claims of discrimination and unfairness could be diminished. As I will mention later in this testimony, FDN supports the Commission's requiring any rate decreases BellSouth offers be across-the-board decreases so all BellSouth customers may share in the benefits of competition.

Q. BellSouth's witnesses point out that ALEC market share has grown during the period BellSouth promotions were in effect and argue that

there should be no limitations on the duration of BellSouth's promotions or the customer contracts with promotional discounts because such limitations could actually limit customer choice. How do you respond?

I think these witnesses turn a blind eye to several important considerations. Chief among these is that the Commission must look at the full effects of BellSouth promotions on competition and on competitors today and anticipate the impacts over a 3 – 5 year horizon.

Even if one accepts that competitors have made gains in overall market share in years past, the ALECs' market share is fragmented, i.e., it takes a hundred ALECs' market shares all added together to arrive at a total that does not even come close to BellSouth's market share. No one can seriously dispute that BellSouth has dominant market power in its incumbent Florida territory today, and BellSouth's status will certainly continue for as long as the Commission permits BellSouth's anticompetitive promotion tactics.

BellSouth's market power is significant to this case because BellSouth has the ability to influence and alter the entire competitive landscape by its conduct. BellSouth's competitors do not have that ability. BellSouth is in a position to threaten the very existence of ALECs; the reverse is certainly not true. This is why BellSouth's promotions must receive a high level of scrutiny and why BellSouth's practices generally cannot be judged by the same standards as ALEC practices.

The Commission cannot look at a BellSouth estimate of current ALEC market share and say that the analysis in this case ends at that. The Commission must evaluate whether the rate of ALEC market share gains has slowed and whether and how the rate will slow in the future. FDN maintains that over time, the rate of ALEC market share gains are likely to stagnate as long as BellSouth's Key Customer type promotional rates are in effect. The Commission has to ask if this is a desirable result for Florida -- slow or no growth for competitors -- because that result has consequences. If the rate of ALEC market share growth stagnates, ALECs will falter, and there will be fewer or no real competitive choices for Florida consumers. When the competitive threat is diminished, BellSouth will be free to raise prices to all customers just as it has already done for many of its customers in Florida.

To have competition that benefits Florida consumers, the Commission has to have healthy competitors with meaningful prospects for sustainable growth. As alluded to in my direct testimony, the Commission should also bear in mind that the BellSouth promotions do not affect resellers (who may wish to resell the promotions) in the way that they affect facilities-based carriers. A reseller's margins may not change measurably if it resells BellSouth promotions (the wholesale discount is the same regardless). However, a facilities-based carrier's margins can change dramatically and take a devastating turn if it tries to beat BellSouth's promotional prices or move to resale. Therefore, if the Commission is indeed serious in its commitment to promote true facilities-based competition, the long-term viability of those facilities-based carriers has to be preserved or Florida's consumers will not have the benefits of choice down the road.

BellSouth witnesses Ruscilli and Taylor ignore other important factors in relation to BellSouth's market status and promotional rate duration. Not only is competition in the local exchange market new, but the competitors are new. Many ALECs are not decades-old enterprises that have reached the point where their businesses "scale." Rather, the ALEC market entrants are new businesses with significant capital and customer acquisition costs and few customers over which to spread those costs. These companies cannot and do not compete on the same or equal footing with the century-old monopoly that is BellSouth. And these companies operate in distinct geographic areas for cost reasons, many attributable to their newness.

The success or failure of the embryonic ALEC enterprises depends substantially on customer growth and customer churn – two variables directly and negatively impacted by BellSouth's promotions. For if the customer base for ALECs fails to grow at a significant rate over a short period, the ALECs will not reach scale and will not have enough customers over which to spread costs, thus increasing the likelihood of financial distress. Recall from my direct testimony the differences between an ALEC and BellSouth each losing a 100 line customer. The ALEC loses revenue, suffers significant unrecovered costs, and endures a substantial impact on the bottom line; whereas BellSouth does not suffer the same proportional impact to its bottom line as does the ALEC, and any retail revenue retail BellSouth suffers is cushioned by the wholesale revenue BellSouth will almost assuredly get from a competitor acquiring the customer. Meanwhile, BellSouth's competitors weaken over time from stagnating growth, which benefits BellSouth over the long haul, and BellSouth can collect higher rates from customers when they are not susceptible to leaving for other providers. BellSouth has all its bases covered! And BellSouth's answer to the ALECs only 3 years or so in business is to try, at the ALECs' financial peril, to beat the promotional prices or resell the promotions – neither of which are viable options as I explained in my direct testimony.

Promoting competition as the '96 Telecommunications Act and the Florida Statutes intended cannot mean just focusing in on the short-term interests of just a few customers fortunate enough to get lower rates today. Promoting competition should be about protecting the best interests of all telecommunications customers over the long term. The Commission cannot protect the long-term public interest if it permits one firm with market power to cripple that firm's lesser competitors (who are just starting out in the business) through unreasonable discounts targeted only at those geographies where the lesser competitors operate. The damage is not just that ALEC A or ALEC B loses a customer today. It is the cumulative effect of those losses and the future harm resulting from the dominant firm's locking up customers for the long term, during the infancy of the competitors, and deterring those customers from migrating in the future. Further, there is the damage done to the dominant firm's customers who do not share in the benefits of competition because they do not receive rate decreases, as they should.

If the Commission is not going to outright stop BellSouth from offering promotional prices in limited geographic areas, the Commission surely must recognize the potential for these BellSouth promotions to stifle competition over time and the need for the Commission to reserve the power or have mechanisms in place to "put on the brakes" and stop negative competitive impacts before it is too late to reverse those impacts. This is precisely why the Commission must place a meaningful limit on the duration of any tariffed promotions and on any agreement or eligibility terms, as well as addressing termination liability. If the Commission realizes at an annual review that total ALEC growth is limping along at 5%, it may be too late to stop the cumulative effect of prior promotions, or even stop BellSouth's 8^{th} Key Customer tariff, so as to do anything to alter the course that the dominant BellSouth has set for the market. Too many customers will already be locked up with BellSouth, and Commission action to release those customers already signed up with BellSouth from termination liability provisions may prove too difficult.

I disagree with the arguments of BellSouth's witnesses that duration limits are unnecessary, and FDN recommends a tariff duration limit and a limit on contract duration of one year with at least a one year "off promotion" period (before a customer who received a discount can again qualify for another). Aside from serving as a means for the Commission to cushion any problems that develop in the competitive marketplace as a result of the promotions, this would also restore some measure of equity to the situation of so many customers not receiving promotional prices because BellSouth has not offered across-the-board decreases.

Q. Do you agree with Mr. Ruscilli's and Dr. Taylor's assessment of the discrimination issues in this case?

No. FDN maintains that BellSouth is unduly discriminating among its customers without justification, as explained in my earlier testimony. This notwithstanding, for BellSouth to justify treating customers in the same class disparately for reasons other than cost differences (such as the Key Customer promotions do), the Commission should require BellSouth to show that the customers not receiving the promotions benefit from the discrimination. I do not believe that BellSouth has yet made such a showing, because instead of getting rate decreases, BellSouth customers not eligible for BellSouth's promotions have felt the full brunt of rate increases. Those customers have not benefited from BellSouth's promotions or from competition.

Attached hereto as Exhibit __ (MPG-5) is a schedule showing the rate increases BellSouth has implemented for single and multi-line business customers since January 2000. Over this period, BellSouth's line rates for some multi-line business customers have gone up over 30%. And these are business customers who have traditionally paid more than the true cost of service so as to contribute to lower residential rates. Thus, it appears customers not receiving BellSouth's promotions are not benefiting from the promotions.

I note that on page 11, line 16, of his direct testimony, BellSouth witness Garcia, states "Competition **is everywhere in Florida**, but is most fierce in the 'hot wire centers' . . . ." (Emphasis added.) Only some BellSouth customers, however, get the full benefits of this "everywhere" competition.

The discrimination issues in this case present several choices for the Commission, but I would like to highlight one of the main dilemmas. To approve BellSouth's arguments, the Commission must ignore equity and tell BellSouth customers not receiving promotional rates that not only do they not qualify for lower rates through no fault of their own, but they will have to pay higher rates. Inevitably, those customers will believe that they are financing the customers receiving the lower promotional rates.

To eliminate this unfair discrimination, FDN supports across-the-board rate decreases for all BellSouth customers. In so doing, the Commission will counter the ALEC arguments that BellSouth inappropriately targets specific geographic markets and that BellSouth unfairly utilizes its market position. Further, with an across-the-board decrease, all BellSouth's customers benefit from competition, and, just as importantly, none are harmed by it through no fault of their own. The Commission will then not have the difficult task of explaining to customers not receiving promotions that their rates have somehow gone up instead of down as a result of competition. The Commission should protect the interests of all of BellSouth's customers, not just a few of them, as competition develops and require any BellSouth rate reductions to apply across-the-board.

Q. How do you respond to Mr. Ruscilli's and Mr. Casey's contentions regarding termination liability of the Key Customer offerings?

In its pleadings in this case, FDN did not initially object to the termination liability provisions in BellSouth's promotions on the grounds that they were an inappropriate measure of liquidated damages. FDN objected to the termination liability provisions on the basis that they were anticompetitive. It is no answer at all for BellSouth to say that its termination liability provisions are like those of many ALECs and therefore not anticompetitive. This is not an issue of creating disparate rules for ILECs versus ALECs. This is an issue of a firm with dominant market power locking up customers in specific geographic areas over an extended duration and what impact that has on competition. It is simply not reasonable to suggest that the impact in the competitive market place of an ALEC and BellSouth having similar termination liability provisions is the same when the ALEC has .015% market share and BellSouth has 90% plus market share. Moreover, look at the practical results of BellSouth v. ALEC termination liability. BellSouth asserts that droves and droves of Florida ALECs have termination liability provisions just like BellSouth. And yet, customers leave ALECs for BellSouth, while, on the other hand, as borne out by BellSouth's discovery responses, very few customers leave BellSouth's promotions. FDN's position regarding termination liability from my direct testimony should be adopted. It is anticompetitive for BellSouth as the dominant firm to lock up customers in the manner the Key Customer tariffs permit.

Q. How do you respond to Dr. Taylor's testimony regarding the role of resale in a price squeeze analysis?

A. To the extent Dr. Taylor suggests on pages 8 – 9 of his testimony (and thereafter) that that the availability of resale cancels out the requirement for a price squeeze analysis, I disagree. Basically, Dr. Taylor argues that since resale of promotions is available, a UNE loop is no longer a monopoly or essential facility to the competitor because the competitor can use other means (i.e. resale) to provide service, and therefore a price squeeze analysis is inapplicable. I do not agree that a loop, which is a UNE by definition and for which a UNE rate is set (because the FCC correctly considers it a facility that competitors need), disappears from UNE status for purposes of a price squeeze analysis only, and is somehow no longer needed because resale is available. It appears Dr. Taylor argues that there should never be a price squeeze under the law where a resale opportunity is available. As I mentioned in my direct testimony, this sort of argument turns the promotion of facilities based competition completely on its head. BellSouth seems content with on the one hand arguing that true facilities based competition is desirable (while RBOCs try to lobby the complete elimination of UNE-P as being little more than resale) and then, on the other hand, arguing that a price squeeze, no matter how egregious, no matter what negative impact it may have on the newly-formed facilities based carriers in the market, may be excused so long as resale is available. BellSouth's price squeeze and resale arguments must be rejected. BellSouth's resale option does not excuse its anticompetitive and discriminatory pricing.

Q. Does that conclude your rebuttal testimony?

A. Yes.

MR. FEIL: With that, I'd tender the witness for cross.

CHAIRMAN JABER: Thank you, Mr. Feil.

Do you have -- Mr. Gallagher, do you have a brief summary of your testimony?

MR. FEIL: Sorry.

THE WITNESS: Yes. I have a very brief summary. I really appreciate y'all's time again. I know that you have better things to do than to referee squabbles like this, and I know --

CHAIRMAN JABER: Not today.

THE WITNESS: Pardon?

CHAIRMAN JABER: Not today.

THE WITNESS: Well, I'm sure that you could be finding something more productive to do in water or electricity or something.

But we have -- we're a sequential issue company. We have one lawyer. We have no real backup here for, for, who knows why, but everybody has their own issues; not because this tariff is a great thing and they all agree with it, but, you know, we're here and it's, it is our very, very most important regulatory issue at this time.

So we saw our sales start to slow in the summer of last year and eventually slowed to a trickle to flat. And I started getting involved personally to try to figure out what was going on because we had the same sales people that were able to generate significant revenue growth for the last couple of years and they hadn't really changed. And I went on some sales calls and I got in front of some customers and I, I believe that our slowing sales is directly related to customers getting one off discounts when we would put a proposal in front of them. Also, the cumulative effect of this tariff being in place for 18 months now has resulted in -- at least we know that in nine months it equated to 20 percent of the market getting locked up. So if you, if you extrapolate 27 months from now, there's no market left. And, and in the case of the sales call I went on, we actually had a customer down in Miami that was eager to do business with us, pulled out his bill, realized he was on a -- we realized, because we know how to read the bill, that the customer was locked up and we had to walk away. There's no way we could get the customer out of that particular deal. So I, I, I believe I have first-hand knowledge of it, and I wouldn't be here otherwise.

And I think you'll see that the numbers will back that up. UNE loop competition numbers have absolutely hit a, hit a brick wall. We'll see those numbers. You'll see the, the dollars that Bell has been able to garner by raising rates for the noncompetitive folks far outweighs what they've lost in the Key Customer. So they're able to get stronger as a monopoly by doing this.

And I just think there's a, there's a lot of compelling evidence here. The -- I recently went to Washington, D.C., two weeks ago to lobby the FCC trying to understand what is going to come down tomorrow, and from a complete bipartisan panel, I met with three of the five Commissioners, and all believe that the FDN model that we're doing with collocation and UNE loop and ubiquitous service is the model that the Telecom Act had in mind when it was created, and assured us that that type of model will be the ultimate future, regardless of what happens with UNE-P.

And I would just ask that this Commission please consider that this will be an issue that you will have to deal with at some point regardless of UNE-P, and that UNE-P will eventually give way to some sort of company that, that looks like FDN at some point. So that's, that's all I had to say. Thank you.

CHAIRMAN JABER: Thank you, Mr. Gallagher. Mr. Feil has tendered the witness for cross. BellSouth, who's doing cross-examination?

MS. MAYS: I would -- Madam Chair, Meridith Mays for BellSouth.

CHAIRMAN JABER: Go ahead.

CROSS EXAMINATION

BY MS. MAYS:

Q Good morning. Good morning, Mr. Gallagher. We met earlier, and I represent BellSouth in this matter.

I want to start with just a real minor housekeeping matter, and it has to do with the issues in this proceeding. When I looked back at FDN's prehearing statement, there were two issues that FDN had no position on, and I just want to confirm this morning those issues were to Issue 2(iii), and it had to do with criteria for tariff when there are configurations. And then Issue 6 had to do with what happens if customers are under the tariff now and there is some change, the Commission makes some change? I just want to confirm, you have no position on those issues still here this morning; is that correct?

A I believe so. I don't know that I completely understand your question.

Q Okay. Well, do you need for me to show you a copy of your prehearing statement or will you accept from me, subject to check, that you had no position?

A Yeah. Subject to check, yes.

Q Thank you. Let's talk about this case a little bit, Mr. Gallagher.

In your direct testimony, when you prefiled it, one of the statements that you made was that ALECs could not survive if they were to adjust their prices below BellSouth's offerings. Do you recall that statement?

A Yes.

Q And, of course, at this course in the proceeding, the only ALEC we have here is FDN; right?

A Yes.

Q The other thing that -- another area I'd like to just go over with you is how FDN competes with BellSouth. And as I understand your testimony, you have stated that FDN generally competes with BellSouth by offering rates that are 20 percent lower; is that correct?

A That's correct.

Q Now I did some review of FDN's web page, and when I looked on the web page, it stated that FDN's prices actually averaged 30 percent less than BellSouth's. Do you recall that?

A You can get, you can get 30 percent on a three-year term. Most of our customers don't take a three-year term, however. So that's where we come out approximately 20 percent.

Q Thank you. Now if -- did you read the testimony of the other witnesses in this matter? Did you have a chance to look at that, Mr. Gallagher?

A I have a big box of it over here, and I have reviewed some of it.

Q And following up again on how FDN offers its prices, one of the, one of BellSouth's witnesses, Mr. Garcia, included some advertisements in his, in his testimony, and there was actually an FDN advertisement.

A I did -- I think I did see those, yes.

Q And in that advertisement that ad showed that FDN's savings could be up to 40 percent. Does that sound right to you?

A We may have done an advertisement like that, yes.

Q Now in this proceeding FDN has stated that its ability to respond to a price discount that BellSouth offers is extremely limited; is that correct?

A Yes.

Q In terms of FDN's authority to respond to a price discount, FDN has the authority to do that, doesn't it?

A You mean from a regulatory standpoint?

Q I do.

A Yes, we do. Yes.

Q And, in fact, in December of 2002 FDN modified its promotional language in its price list and specifically filed in its price list the ability to meet any offering out there.

A Correct. That was right about the time, I believe, that we lost the hearing here to get the Key Customer program stopped.

Q Another position that FDN takes in this case is that BellSouth should have certain restrictions placed upon its ability to offer promotions; is that correct?

A Yes.

Q And you have specifically provided a figure of 40 percent, and FDN is stating that until ALECs obtain a

40 percent market share, that this Commission should impose some type of restriction on BellSouth; right?

A Yes.

Q Now when -- staff in this case has asked and actually has filed in their exhibits a series of questions, and one of them had to do with how FDN reached that 40 percent figure. Do you recall generally that discovery question?

A Yeah, I do. When my people come to me with problems, I try to have them have some sort of solution. And when we come to this Commission, I think we should have some sort of solution.

So we, we believe that 40 percent would be a starting point number that is very similar to about the time when AT&T was declared nondominant and they were unable to price one off. That seemed to be a, a number that had some historical precedent. And, and that's why we put it out there.

Q So other than the past situation with AT&T, there is no other document or item that you can point me to that shows me how FDN reached the 40 percent figure?

A That's correct.

Q Are you familiar, Mr. Gallagher, with this Commission's Annual Report on Competition that was issued in December of 2002?

A Yes.

MS. MAYS: Now what I'd like to do, if it's appropriate, Madam Chair, is provide the witness a copy of that report.

Just as a matter of procedure, Madam Chair, I believe counsel for FDN has agreed that we could stipulate and have admitted into the record the December 2002 Annual Report on Competition.

COMMISSIONER JABER: Mr. Feil?

MR. FEIL: That's true. I did have some provisos which I'd like to address later when their witnesses get on the stand, but I don't have a problem with stipulating the exhibit.

CHAIRMAN JABER: Okay. Are you asking that it be identified now, Ms. Mays?

Hearing Exhibit 8 is used for the PSC's Report on Competition dated 2002, December of 2002.

MS. MAYS: Thank you, Madam Chair.

(Exhibit Number 8 marked for identification.)

COMMISSIONER DAVIDSON: Madam Chairman, I'd like to add a comment that this is a mighty fine report.

CHAIRMAN JABER: Thank you, Commissioner.

BY MS. MAYS:

Q Mr. Gallagher, do you have a copy of that in front of you?

A Yes, I do.

Q If you could turn all the way back to Appendix C, which is on Page 67 for me, please. Let me know when you've gotten there.

A Yeah. Yes. I'm there.

Q Okay. Now if you go all the way to the last column of Exhibit C, you will see ALEC market share expressed in percentages in exchanges. Do you see that?

A Yes.

Q And if I were just to glance down there and look for the exchanges in which ALECs have at least 40 percent market share, the ones that I see are ten of them. They start on Page 69 with Flagler Beach, then they go to Ft. Lauderdale, which is also on Page 69, then Jacksonville on Page 71, Miami on Page 72, Middleburg on Page 72, Orlando on Page 73, Pensacola on 74, Pompano Beach on 74, Reedy Creek on 74 and St. Johns on Page 75.

A Yes, I saw that -- I saw that earlier.

Q And in all the other exchanges, if this Commission were to adopt FDN's position, there would be some type of restrictions on BellSouth's promotions; is that right?

A Yes.

Q Does FDN actually compete in the exchanges, all of the exchanges that have at least 40 percent market share?

A You know, I don't think -- you had said Flagler?

Q Yes, sir.

A I don't think we're in Flagler.

What was the other -- what was -- I'm sorry. Orlando clearly, yes.

Q Pardon?

A Orlando, yes.

Q Yes. Pompano?

A Yes.

Q Reedy Creek?

A No.

Q No? And St. Johns?

A No.

Q Let's talk a little bit about resale for a minute, if we could, Mr. Gallagher.

You do understand that BellSouth is willing to allow FDN or any ALEC to resell the Key Customer promotion, don't you?

A Yes.

Q And, in fact, FDN asked BellSouth if it could resell the Key Customer promotion and was told that it could; is that right?

A Yes.

Q Now FDN has provided resale to 20 to 30 lines on a trial basis, hasn't it?

A We have provided resale, yes.

Q One of the other issues, as I understand your testimony, is that you have an issue with termination liability; is that fair?

A Yes, a very big issue with that.

Q And FDN itself has a tariff in place that allows FDN to impose termination liability on customers that leave FDN; correct?

A Yes.

Q FDN can impose unpaid nonrecurring charges; is that right?

A That's correct.

Q It can also impose fees owed, that FDN would owe to third parties?

A That's correct.

Q And it can also impose either $10 per line per month remaining or $100 per line per month remaining depending on which is the lesser amount; is that --

A Yes.

Q Okay.

A We, we -- our collections rate on, on that is very, very low. So when we impose something like that, it's very low. And, also, that is something that we've put on the table, I think with you all, that we would consider, you know, lowering our contract terminations, if you all would.

Q Now staff asked FDN about termination liability, and as I understood one of FDN's concerns, and I'm going to quote here, it was that termination liability -- I'm not quoting exactly, I'm sorry -- but termination liability not be so high that prospective customers would shy away from the service. And I'm referring specifically to staff's Interrogatory 36B. Do you recall generally that?

A Generally, yes.

Q Can you just tell me, Mr. Gallagher, in the course of your hands-on experience with customers in the market when the last time a customer told you, look, I'm not going to FDN because your termination liability is so high?

A It has happened.

Q Has it -- how often?

A I couldn't tell you how often.

Q When was the last time it happened?

A I would have to interrogate our sales force, but I could get that answer.

Q You don't know here today?

A No, I do not.

Q Another concern you have had, you have expressed with respect to BellSouth's termination liability is that you contend it locks up the market; is that right?

A Absolutely.

Q Isn't it true that under the terms of the Key Customer offerings, a customer with, for example, ten lines could migrate nine lines to FDN and keep one line with BellSouth and that customer would not have any termination liability? Do you understand that?

A Under the current January tariff or the one that was filed -- customer that was signed up in July of last year?
Q Under any of them.
A No. It's not my understanding that that's how it worked.
Q Okay. Let me direct you to FDN's responses to interrogatories, in Number 5A specifically. It's to staff's.
And in that response you have given an example of a customer who actually did, in fact, want to port all but one line to FDN. Do you recall generally that response?
A Could, could I get a copy of that real quick?
Q Sure.
A I've got second through fifth here. I'm looking for first. Is that the one? Is that where it is?
Q Actually your response is to staff's second.
A Okay.
Q And I'm looking on Page 3.
A My pages must be wrong because I only have two, two pages.
Q Okay. I'm going to have Ms. White approach you and --
A Okay. What was your question then?
Q I just wanted to direct your attention to an example of an anecdotal evidence you provide where a customer actually wanted to port all but one of its lines to FDN, as I understand

your response. Do you see that?

A Yeah, I see. I've got the first sentence of it.

Q And I guess my question, does that refresh your memory as to the terms of BellSouth's Key Customer promotions that a customer could actually leave BellSouth's service for -- if it had ten lines, it could take nine lines over to FDN, keep one line with BellSouth, and it would not have termination liability. Does that help you at all?

A No.

Q Okay. That's fine. We'll move on.

Another position that you have taken has to do with discrimination. And as I understand your position, and I think Mr. Feil addressed it briefly, is you want, anytime BellSouth offers a promotion, you think that every business customer should be offered the promotion; is that right?

A I believe that when BellSouth lowers its prices, it should lower its prices for everyone.

Q Is it true, Mr. Gallagher, that when FDN offers service to its customers, that it offers different prices, say, to a customer located in Sprint territory versus a customer located in Verizon territory?

A That's correct.

Q And it's also true, isn't it, that this Commission has historically had rate groups in effect in Florida where a small business customer in Rate Group 12 would not have the same price as a small business customer in Rate Group 1?

A Right.

Q And it is also true, isn't it, Mr. Gallagher, that FDN does not serve all of BellSouth's serving territory?

A Not -- no, it does not.

Q FDN has, in fact, selected the areas in which it chooses to offer service.

A We've selected five BellSouth markets and we are in every -- everywhere -- almost 100 percent of those markets.

Q Let me see if I can attempt to walk you through a hypothetical, Mr. Gallagher. And Mr. Lackey addressed it briefly in his opening, and I just want to see if I can lay this out for you.

I want for the purposes of this hypothetical to assume that there are 1,000 business customers and they are located in groups of 100 in ten different areas. Do you have that in mind?

A Yes.

Q And for the purposes of this hypothetical, I want you to assume that the cost of the service is $80 per month. Are you with me so far?

A Okay.

Q So under this hypothetical, if the cost is $80 and the rate -- the rate the customer is going to pay is $100. Okay? And so under that hypothetical, the provider would make $20 per month for 100 customers, I'm sorry, 1,000 customers. So $20 per month, 1,000 customers total. Are you with me?

A There's a cost of $80.

Q Right.

A To you or to me? To me?

Q To me pursuant to BellSouth.

A Okay.

Q Okay?

A Okay.

Q So if I have 1,000 customers, I'm making $2,000 in each of these separate ten geographic areas; right?

A 20 times 100?

Q Yeah.

A Okay.

Q I think I'm messing up my math here. 20,000 per month -- anyway, you get the hypothetical. We're making $20 --

A I think so.

CHAIRMAN JABER: Yeah. But I need to make sure I get the hypothetical.

THE WITNESS: Where, where does your $80 of cost come from?

MS. MAYS: I get in trouble when I do these. Let's try it again.

CHAIRMAN JABER: And, you know, it's the simple math that gets you every time.

MS. MAYS: Absolutely. So let's back up again. We have --

CHAIRMAN JABER: You said 1,000 customers.

MS. MAYS: I have 1,000 total customers.

CHAIRMAN JABER: Okay.

MS. MAYS: They are ten groups, 100 customers per group.

CHAIRMAN JABER: Okay.

MS. MAYS: They are paying $100 per month and the cost is $80 per month. So the provider makes $20,000 per month or $2,000 in each area.

BY MS. MAYS:

Q Are you with me? Are you with me so far, Mr. Gallagher?

A I'm writing this down. I think I've got it.

Q Now let's assume that FDN comes in and FDN says, I want to serve one area. And FDN says, I'm going to compete on price and I'm going to offer my service at $85 a month. Okay?

A Okay.

Q Now BellSouth obviously doesn't want to lose its customers, so it says, I'd like to meet FDN's offer and I'm going to lower my rates to $85 a month and meet FDN's offer. If BellSouth's costs are $80, still getting $5 a month.

A Okay.

Q So hopefully we compete head to head and that's what happens. Okay?

If I understand FDN's position, what you would like us to do is you would like BellSouth to lower its prices to $85 to every single customer, including the nine areas where FDN is not competing in this hypothetical.

A Yes.

Q And if we take the math to its extreme, and BellSouth has, has gone from making $20 a customer to only making $5 or losing $15, if you multiply the 900 customers in the other areas times $15, BellSouth would lose $13,500. Does that sound about right?

A Yes, in that scenario. But you have the market power to raise your rates elsewhere to, to more than make up for that, which is, I think, what we're here talking about.

Q Would you agree with me just simply from a business person's perspective, Mr. Gallagher, that losing $13,500 does not make economic sense?

A Of course. But I don't have a monopoly. I mean, I can't -- you can raise it in other areas to make up for that.

Q Now when you proffered this position that you wanted these across-the-board decreases, you provide, one of the things you provided this Commission with was your prehearing statement.

A Right.

Q Do you have a copy of your prehearing statement, Mr. Gallagher?
A I don't know that I do.
Q Pardon?
A I don't know that I do.
Q Let me provide him one, if I could.
If you'll flip with me, Mr. Gallagher, to Page 3 of your prehearing statement in about the middle of the page --
A Yes.
Q -- you offered several rationale for why you thought the across-the-board decrease should go into effect. And one of the reasons that you offered was that competitors would not be as drastically disadvantaged; isn't that right?
A Yes.
Q Let's turn to your exhibits. I want to talk to you a little bit about your exhibits, if I could.
A Okay.
Q And one of the exhibits, and we've talked about it some, but it's MPG-1, and you've provided information in MPG-1 about FDN and its tariffed rates; is that correct?
A Yes.
Q And you provided some margin or revenue information in that exhibit; correct?
A Some -- I'm sorry. What was that?
Q You provided some margin information in that exhibit,

as I understand it?

A Yes.

Q Now when you included the margin, as a general matter, do you, and I'm talking about FDN, you did not include any revenue or margin that FDN realizes for selling services other than local service; is that right?

A That's correct.

Q And it's true, isn't it, that most of FDN's customers purchase also from an intraLATA and long distance, don't they?

A Right. We, we excluded the revenue and the costs though from that.

Q Let me ask you about MPG-3, if I could, please. That's an order from the Missouri Commission.

A Yes.

Q And you have summarized what the Missouri Commission did in your direct testimony at Pages 27 through 28. And in that testimony you state, the Missouri Commission suspended Southwestern Bell's win-back tariffs; right?

A Correct.

Q Now if I were to turn to your Page 16 of 21 of MPG-3, if I'm reading that correctly, the Missouri Commission stated that, "Southwestern Bell is correct when it contends that the Commission has previously approved, or allowed to go into effect, tariffs that contain similar, or nearly identical provisions to the provisions that it is rejecting in this order." Is that right?

A You know, I'm not a lawyer, so I don't know the exact law that was put in here. But it's my understanding that the Missouri Commission did what I said it did in my testimony.

Q Did you -- do you also see in the Missouri Commission's order at Page 16 of 21 that the Missouri Commission stated that it was not attempting to establish a rule with application beyond the facts of this case?

A Uh-huh. I would take your word for that.

Q Now you also note in your testimony that in Missouri ALECs had 22 percent of the business market; right?

A Yes.

Q And we've talked a little bit about this Commission's report. And in that report, of course, the ALECs in Florida have 26 percent in the business market; right?

A Correct.

Q And in BellSouth's territory, ALECs serve 33 percent, a little over 33 percent of the business market; right?

A Yes.

Q Now in, in the Missouri decision that you've attached, you note there were 66 certificated ALECs; right?

A Yes.

Q And in Florida in 2002 there were 122 ALECs that reported to this Commission they were providing service; right?

A Well, I think that the -- actually when I read this, which is a really great summary of competition for the state, there is some data in here though that's somewhat dated. I don't believe that there are that many certificated anymore.

For example, I saw several bankrupt -- Network Plus is in here. And I'm wondering if some of that data didn't get into this report, because I believe that it could be slightly overstated from that standpoint.

Q I'm not sure I understand. Are you saying that this Commission's report is --

A That -- well, for example, Network Plus is cited as a certificated, you know, guy in here, and they're gone.

Q I'm not asking you about the total number of certificated ALECs. I'm asking you that, and I'll direct your attention specifically to Page 22 of this Commission's report, if it would be helpful, that of all the certificated ALECs, which I think were substantially more than 122, 122 actually reported that they were providing service.

A Okay.

Q You attached another exhibit to your direct which was a Texas rulemaking. I'm referring to MPG-4. Do you recall that?

A Yes.

Q Do you recall that the draft rule that you attached to your testimony was not a final commission order?

A Yes. It's been brought to my attention, yes.

Q Were you aware that the Texas Commission, in fact, revised the rule that it's considering that you have attached to your testimony?

A Yes. I've become aware of that.

Q And you're aware that they changed substantially really what they're looking at doing?

A Yes. It's my understanding that they, they tend to look at it, case-by-case basis on the economics.

Q Would you accept to me, subject to check, that the current rule that the Texas Commission is looking at when looking at restrictions does not prevent a company from making retention and win-back offers during a customer-initiated communication?

A I would have to take your word for that.

Q Now I want to ask you a little bit, Mr. Gallagher, about how FDN has been harmed, because you've stated, as I understand your testimony, that you have suffered irreparable harm because of these promotions. And the Commission asked you to give it some information, and they asked you for information from the end of January of 2002 to the end of February of 2002 about customers and lines. Do you generally recall those questions?

A January 2001 to February 2002?

Q I'm sorry. It was January 31st, 2002, which is when the Key Customer program, the first one began.

A Right.

Q To the end of February of 2002.

A Right. Okay.

Q And during that time frame, as I understand your, what has happened to FDN, you lost 770 lines. Does that sound accurate to you?

A Yes.

Q Can you tell me of those 770 lines, which of them went to BellSouth as opposed to any other ALEC?

A No, I can't. Well, we know from a general standpoint that when we lose a line, a port out, about 70 or 80 percent go back to BellSouth.

Q And you know that how?

A By looking at the port out request information that we get. And we don't know if they're going to a BellSouth resaler or to a UNE-P provider after that, but we do know they go to BellSouth first.

Q So it's possible that they ultimately end up with another ALEC?

A It is possible.

Q Do you conduct actual customer exit interviews to ask them why they left and to whom they're taking their service to?

A Not on a thorough basis, no.

Q And so from the time you filed this complaint about a year ago until now, have you taken, kept any sort of records about customers leaving and how many go to BellSouth?

A The number you're talking about was a net loss number. So, therefore, it's the difference between adds and disconnects. So you can either get there by having higher disconnects or lower adds. In our case it was more lower adds. We weren't able to sell as many. And that's -- again, we're unable to sell as many new lines because they were locked up under Key Customer. We could not sell new customers.

Q And you know this how?

A Because we have our sales numbers.

Q So you don't have any market data, any, you know, catalogues, any exit interviews that you've conducted that tells you for a fact that you couldn't make these sales because of BellSouth?

A We do. We do. We do have information from our sales force. We track their productivity. And they used to be able to sell 50 lines apiece, a person every month, and now they can only sell 25. Or in the case of -- and with our churn rate, with the amount we lose, we're now down to where we're net adding zero.

Q And let me, let me go back to just the specific time period we were talking about, which was January 31st to February 28th of 2002.

A Right.

Q During this time period what you told me was those

770 net lines lost, as I understand your testimony.

A Right.

Q And during that same period of time you gained 6,609 lines?

A Right.

Q So the, the actual lines you gained --

A For -- right. In that case, 2002, that would be correct.

Q Help me understand, if you could, Mr. Gallagher, when, when you specifically, when you specifically link this Key Customer program of BellSouth's to FDN's harm, what exactly you can -- what facts you can point to that says I lost customers, I lost lines because of BellSouth.

A We have our sales force information. We know that the small business customers churn at a certain rate. And if you get to a certain size and you can't sell anymore because -- what we believe the market is getting locked up at a very fast clip due to this termination liability, then your net add number is going to be negative. So, therefore, you will, you will shrink and you will eventually, you know, disappear.

Q So aside from conversations you have had with sales folks and your general summary of those conversations that you've just provided, you don't have additional facts here today, do you, linking these problems to BellSouth?

A I think we have some data that, some confidential information that we're offering for the record about our sales figures.

Q What -- I'd like to get to that data. I'd like to hold that, if I could.

A Okay.

Q And I just want to make sure I understood some testimony you gave just a little bit earlier. And I think, as I recall, you said you estimated 70 to 80 percent of the customers you lose go to BellSouth; is that correct?

A That's correct.

Q So when you answered discovery with a 90 percent figure, the actual figure is really 70 to 80 percent?

A You know, I would, I would offer our -- as a separate data, I'll just offer what our monthly numbers are and we'll give them to you. We -- you know, sometimes it's 70, sometimes it's 90. 70 to 80 percent of our lines when they port out and go to a competitor, typically that competitor is BellSouth. But the numbers are what they are, so you're welcome to them.

Q I'd like to hold, if I could, just line numbers, and we'll get back to that.

I do want to ask you about some specific examples that you gave to, that you gave in response to staff's second set of interrogatories. And I'm specifically referring to, again, staff's Interrogatory Number 5A.

And you've given five examples, as I have, as I count them, of anecdotal evidence. That's, that's what you call it.

A Okay.

Q And I just want to walk through those with you. The first one referred to a customer in Jupiter, and we talked a little bit about that customer earlier. And as I understand your discovery, the customer wanted to transfer all lines but one to FDN.

And my question to you is if you know with respect to that customer whether, in fact, the customer did go ahead and transfer those lines to FDN?

A I do not know in that specific case, but I could find out.

Q What about the example you gave of the customers of -- two customers in Miami? Do you know, in fact, whether they moved to FDN or not?

A No, I do not.

Q Would you know as far as the other examples, do you know specifically whether --

A No, I do not.

Q Let's go back to the line growth information, if we could.

A Okay.

Q And as I understand your testimony about line growth, your testimony is that it has stagnated.

A Yes.

Q Now you did provide to BellSouth data, and I don't want to release any confidential data, but you provided some data that talked about the time frame of July 2002 to February 2003. Do you recall generally that data?

A Yes.

Q And as I understand that data, for the time frame in question overall FDN had line growth; is that correct?

A That's correct. If you look closely at it, it's mostly in the beginning of the year in 2002 when Network Plus went, went bankrupt and the customers -- you know, you got a lot and we got a lot. It's in your data, too.

In the end of the year though, in the latter half of the year I think the data supports, as I discussed in my opening statement, that the cumulative effect of this tariff has started to hit us.

Q And as I understand, I'm assuming that the actual percentage is not confidential, but I don't want to make that assumption. May I give the percentage?

A I would rather that the, you know, the confidential information stay confidential. But, obviously, it's important that the Commission sees it.

Q That's fine. We'll, we'll submit that later.

Would you accept for me, Mr. Gallagher, subject to check, that in each of the hot wire centers where you did have some loss, that in those specific hot wire centers based on this Commission's report, that the number of ALEC providers grew and that the percentage of lines served by ALECs grew?

A Would you be talking about facilities-based ALECs or UNE-P ALECs?

Q I'm just talking about ALECs.

A I can't -- I don't know anything about the UNE-P ALECs and I personally don't, would not count them as competitors in light of what's going to happen tomorrow and your stated position on what you guys want to happen with those guys.

Q My question, and I just want to make sure we, if you can, that you try to answer the question I've asked you, is that whether you would accept from me, subject to check, that in each of the hot wire centers where you experience line loss, that if you look at those hot wire centers and you look at this Commission's report, that the number of total ALEC providers increased in those hot wire centers and that the percentage of lines served by ALECs, excuse me, also increased in those hot wire centers?

A I would, I would highly doubt your data there because I think you all are still counting collo cages from ALECs that are long dead. So I would, I would not accept that. I would want to check that.

Q You understand that it's not my data, it's this Commission's report?

A I, I just don't believe it, so I'd like to see it with my own eyes.

MS. MAYS: Okay. Can I have just a moment, please?

CHAIRMAN JABER: Sure.

BY MS. MAYS:

Q Now you filed an affidavit with your complaint that initiated this, this case. Do you recall that affidavit, Mr. Gallagher?

A Yes.

Q Okay. And in that affidavit you testified that the Key Customer promotions would impair FDN's ability to compete to the point of jeopardizing your viability as an ongoing concern. Do you recall that in the affidavit?

A Yes.

Q Let's talk a little bit about FDN. FDN first started offering services in Florida in April of 1999; is that right?

A Yes.

Q And in 1999 FDN had $2.5 million in revenue; is that right?

A Yes.

Q Are you aware, Mr. Gallagher, that the first time BellSouth ever offered any Key Customer promotion was in 1998?

A Yes.

Q Now from 1999, we then get to 2000, and during 2000 FDN had $20 million in revenue. Does that sound right?

A Yes.

Q Then in 2001 FDN had $42.2 million in revenue; is that right?

A You've been reading our web page.

Q I sure have.

A You guys love our web page.

Q We love your web page.

A It's a -- there's a lot of marketing stuff there, you got to realize, just like your web page. But, yes, those numbers are correct.

Q Okay. Now we talked earlier about the fact that you provide local service and other services; right?

A Yes.

Q And, in fact, in 2002 you provided this Commission with numbers about -- of the $42.2 million, how much was local and how much was other stuff. Do you recall that?

A Oh, I'm sure we did.

Q Okay. And I'm assuming that those numbers are confidential, so I will not --

A Thank you.

Q -- release them. Okay.

You also provided some numbers of customers in that same time frame, which I don't know if that number is also confidential. Is it?

A I, I think so.

Q Well, let's talk about some public information then about customers and lines, if we could.

In August of 2001 would you agree with me that FDN served approximately 60,000 voice and data lines in Florida?

A You know what, I actually have those numbers. Could you hand me my bag right there? I brought those numbers because I figured you all would be asking me about that. So hold on one second.

What, what month are you asking there?

Q Let me try to make it easier for you, Mr. Gallagher. I'm going to give you just a copy from some testimony you gave in the cost docket that we asked you then about some lines.

A Okay. Then, then that's, then that's right.

Q Okay. And so the number we're talking about is 60,000 lines in August 2001. And you've agreed that that sounds correct?

A That's correct.

Q All right. And then in March 2002 you testified that you were serving approximately 80,000 voice and data lines; right?

A That's right.

Q And in October of 2002, you reported that your company was on track to exceed $70 million in revenue; is that right?

A For the year.

Q Yes. Year 2002?

A Yeah. Yeah.

Q And in October of 2002 your company released information that it had exceeded 100,000 lines; right?

A Yeah. A little bit of self-promotion there, but, yes.

Q Okay. March 2002 to October 2002, if my math is right, you got about 20,000 lines?

A If you count data lines, also. I mean, we, we sort of puff up our data lines a little bit by counting in by 64 channels to try to make our data lines sound better. But we count voice lines one off like, like we're supposed to. But there's a little bit of marketing going into the line counting figures.

Q Okay.

A So that you're aware of that.

Q Thank you for explaining that to me.

Okay. The summer -- we're still on Year 2002. I can keep your attention there.

A Okay.

Q And in the summer of 2002 your company obtained about $35 million in venture capital, didn't it?

A In the summer of 2002 --

Q Yes.

A -- we restructured our company.

Q You restructured. And as part of that restructuring, is it correct that investors provided you with $35 million in capital?

A New investors did. All the old investors, including myself, lost everything that they had in the company.

Q Okay.

A Because we defaulted on our debt and we had to purchase our debt with the new facility. So it wasn't a happy $35 million raise. It substituted for a bank loan that was in place.

Q And once you substituted for that bank loan, FDN, in fact, is now debt free; is that right?

A Correct.

Q And in 2002 FDN became cash flow positive, didn't it?

A In 2002 --

Q I'm sorry. 2002. I'm getting my years mixed up. 2002, in June, you became cash flow positive.

A EBITDA positive.

Q Pardon?

A EBITDA positive. Cash flow, not cash flow positive.

Q EBI -- I'm sorry.

A E-B-I-T-D-A, earnings before interest taxes.

Q Okay. Now after -- in August 2002 you reported that you also expected to get positive net income by the end of the year?

A Is this off the web page? Is that --

Q It is.

A Okay. Well, yeah. I mean, that's what we say. It's the same way when you guys have a bad earnings announcement, you say positive stuff. I mean, that's what that is.

CHAIRMAN JABER: I'm going to look at your web pages more often.

THE WITNESS: It's not that good. These BellSouth folks love it though. I am amazed.

BY MS. MAYS:

Q Well, in keeping, after August 2002 when you report a positive net income, then in September 2002 you said you were debt free and profitable, didn't you?

A We have never -- we had one month of net income because we reversed the debt off the, off the balance sheet. But we've never -- we are not net income positive.

Q So your web page, the news releases in August and September were inaccurate?

A I don't think they said we're net income positive.

Q Let me just check it.

CHAIRMAN JABER: Ms. Mays, while you do that --

MS. MAYS: If I, if I could, please, Madam --

CHAIRMAN JABER: While you do that, why don't we take a ten-minute break.

MS. MAYS: Sure.

(Recess taken.)

CHAIRMAN JABER: Let's go ahead and get back on the record, Ms. Mays.

MS. MAYS: Thank you, Madam Chair.

BY MS. MAYS:

Q Mr. Gallagher, before we broke I believe I handed, passed out two news releases off of FDN's web site. The first is dated August 16th, 2002. The second is dated September 9th, 2002.

And looking specifically at the August 16th, 2002, there's a statement in there that Florida Digital became cash flow positive in June and expects to have positive net income by year's end. Do you see that?

A Yes. This was written by -- it was taken from a release, and it was an interpretation by someone at a Daily Deal Magazine.

Q Okay.

A For the --

Q And then in the September 9th, 2002, they actually quote you, and you are quoted as saying you are debt free and profitable.

A That's correct.

Q Now could we have those two, if we could, Madam Chair, press releases marked as the next exhibit?

CHAIRMAN JABER: Composite exhibit or do you need them identified separately?

MS. MAYS: They can be a composite.

CHAIRMAN JABER: Okay. The September 9th, 2002, Miami Herald article?

MS. MAYS: Yes, Madam Chair.

CHAIRMAN JABER: And the August 16th, 2002, Daily Deal article are identified as composite Exhibit 9.

MS. MAYS: Thank you.

(Exhibit Number 9 marked for identification.)

BY MS. MAYS:

Q Now just so I'm clear, Mr. Gallagher, in terms of lines, I just want to understand earlier testimony. It is not your testimony today that FDN has lost lines overall. Your testimony is, in fact, that FDN's line growth has, has not grown as fast; is that right?

A Right. Or flattened in some cases.

Q Okay. Now FDN recently announced that it plans to purchase the assets of another ALEC, didn't it?

A Yes.

Q And with that purchase it will gain about 70,000 more lines; is that right?

A Approximately in Florida and Georgia, yes.

Q You referred in your summary to a meeting you recently had with the FCC. Do you recall that?

A Yes.

Q And during that meeting, which I believe was in February, this month, February of this year, you provided an ex parte, you filed an ex parte following the meeting; is that right?

A Yes.

MS. MAYS: If I could, Madam Chair, I would like to distribute that ex parte.

CHAIRMAN JABER: Go ahead.

MS. MAYS: If we could identify that as the next exhibit.

CHAIRMAN JABER: The February 6th, 2003, ex parte filed by FDN is identified as hearing Exhibit 10.

MS. MAYS: Thank you, Madam Chair.

(Exhibit Number 10 marked for identification.)

BY MS. MAYS:

Q I'd like to, if I could, direct your attention, Mr. Gallagher, to the handout that's attached to that. And there's a Page 2 that says, "About FDN." Do you see that?

A Yes.

Q And when I look at that, I think the fourth bullet point down on there is, says, "Rapid growth." Do you see that?

A Yes.

Q And it references 110,000 voice and data lines in service. Do you see that?

A Yes.

Q And, of course, earlier we talked about in October 2002 you had announced 100,000 lines.
A Right.
Q So by February 2003 you've gained 10,000 more lines; correct?
A Most of all of those were data lines though. Our voice lines, again, have flattened, and we've sold some DS-3s. And we count those DS-3s as 672 lines.
Q And, again --
A So most of that growth is in data lines.
Q Thank you. And, again, when you say flattened, you're not talking about a decrease. We're talking about a slow.
A Correct.
Q And then if you go over to the second, the Page 3 of that handout, the first item is "Financially healthy" and then "Free cash flow positive"; isn't that right?
A Correct.
MS. MAYS: Okay. Thank you, Madam Chair. I have no further questions.
CHAIRMAN JABER: Thank you.
MS. MAYS: If we could, we would like to admit -- oh, I'm sorry. We have to wait until the end.
CHAIRMAN JABER: Right.
MS. MAYS: Sorry.

CHAIRMAN JABER: No problem. Staff?

MS. BANKS: Thank you, Madam Chair.

CROSS EXAMINATION

BY MS. BANKS:

Q Good morning, Mr. Gallagher.

A Good morning, Ms. Banks.

Q I have just a few questions I want to ask on behalf of the Commission. I do want to put you at ease; because I'm not a math whiz, you don't have to worry about a hypothetical with a whole lot of numbers.

A I'm a math major and I was having a big -- I was having a little trouble there, so.

Q I'm assuming you still have your direct testimony handy.

A Yes.

Q If you would -- and this is of your direct testimony, Page 6, and I'm looking at the bottom of that page beginning at Line 23.

A Yes.

Q And it goes over to Page 7, Lines 1 through 2.

A Yes.

Q In that portion of your direct testimony you state that FDN must pay BellSouth an installation fee of well over three times the monthly charge to move the customer from BellSouth to FDN; correct?

A Yes.

Q Does FDN charge the customer any installation or other nonrecurring up-front fees when switching a new customer over from BellSouth?

A We typically can charge the customer nonrecurring when it's a new order. So we do collect it in a small percentage of our line sales.

When we're converting from BellSouth, we typically do not charge nonrecurring.

Q Okay. And just, I guess, kind of a related question regarding discounts that are offered, is it FDN's position that discounts are not available to all BellSouth customers in hot wire centers or all BellSouth customers in the State of Florida?

A Theoretically the discounts are available to all customers in the hot wire centers, just not everybody in Florida.

Q Okay. Moving over to Page 13 of your direct testimony, and that's at Line 17 through 19.

A Okay.

Q You state that BellSouth should alert all eligible customers of offers in the same way so that BellSouth does not in practice manipulate the eligibility criteria; is that correct?

A Yes.

Q I'm trying to understand what you mean by "the same way." And I'm assuming we have, I guess, three potential class of customers: Eligible customers, existing customers, or those customers that are not customers of BellSouth. Could you just explain or elaborate how they should be notified in the, quote, unquote, same way?

A Well, you know, what I mean there is, for example, when we're trying -- we sold a customer and they're, they're, say, a five-line customer and they have ADSL on their main line. The first thing the customer has to do is we can't -- we have to have them move that ADSL to a back fax line because of matters previously before this Commission so that we can port the lead number to us. So we -- there's no process for that, so they have to call the BellSouth retail office and say, I need to have my ADSL moved to my fax line. And at that point a win-back happens. So -- or if a customer calls in and says, I've got a proposal from FDN, then the special pricing happens.

My point was I don't think that they would offer this across the board to all their customers.

Q So you're not saying they shouldn't be marketed differently?

A It should be consistent, whatever it is. And it shouldn't be anticompetitive, I think, is what the gist of my saying that.

Q Okay. Still making reference in your direct testimony on Page 15 at Lines 8 through 11.

A Yes.

Q Okay. You state that, "BellSouth should be barred from offering direct or indirect discounts of more than ten percent off total billed basic and nonbasic telecommunications services, including hunting and all features"; correct?

A Yes.

Q Can you just elaborate what's the rationale for the ten percent?

A I had just talked to some colleagues of mine around the country and had seen what is available and what's not available and where it seems to be, there seems to be thriving competition. And it seems, it seems to me that, you know, that seemed like a reasonable number. There's no, you know, detailed math behind that other than that seemed to be a threshold.

Q Okay. Moving over to Page 27, and we're still in your direct testimony, and this is at Lines 10 through 15. And here you're referring to an ALEC exiting a market.

A I'm sorry. On Page 27?

Q Page 27 at Lines 10 through 15.

A Okay.

Q You state that, "If the Commission permits BellSouth to continue to offer Key Customer type discounts, the Commission should level the competitive playing field by directing BellSouth not to offer such discounts to customers of a departing ALEC until 30 days after the date that those customers are subject to disconnection or rolling over to BellSouth as a default carrier"; is that correct?

A Yes.

Q So do you believe it is in the best interest of the consumer to actually limit the choices of the period that they'd have to wait?

A Well, what that -- that comes -- that stems directly from the Network Plus issue where Network Plus was going out of business and they send their customers a notice that was somewhat scary for the customers that said, you will be out of phone service in a certain number of weeks, you know. And so these people pick up the phone and call BellSouth and were just enrolled in mass in the Key Customer, we believe.

Q But wouldn't this time period that you're proposing that the Commission take limit the choices for a new provider when a customer is exiting -- a customer's provider is exiting the market?

A When a customer provider is exiting the market -- I don't think it would -- I think that, that there should be some sort of cooling off period so that -- the monopoly is going to get most of the people when a customer is exiting. Everybody is going to run for the exits and they're going to run for BellSouth.

So what we're saying is just don't let BellSouth lock them all up while there, while there's a panic going on. There should be -- we certainly don't want to limit the consumers, whatever they want to do. But at that point I don't know that there's rational, competitive thinking going on. There's just a mass exodus.

Q Okay. On that page -- I guess going back to Page 18 of your direct. I'm at Lines 14 through 18.

A Yes.

Q You state that you believe that duration of the discount should be no greater than 60 to 120 days, depending on the level of the discount. You further state that at the current levels offered in the Key Customer programs, you would say that no more than 90 days should be permitted.

A Yes. Again, just trying to come up with a suggestion of compromise.

Q Okay. And you say that BellSouth should not be permitted to provide discounts again thereafter for another year; correct?

A Yes.

Q Okay. Going over to Page -- and I don't know if you have your rebuttal testimony in front of you.

A Yes. I have it somewhere here.

Q Referencing Page 6 of your rebuttal testimony.

A Okay.

Q I'm at Lines 19 through 23.
A Yes.
Q Okay. Here you state that, "FDN recommends a tariff duration limit and a limit on contract duration of one year with at least a one-year 'off promotion' period." That period being "before a customer who received a discount can again qualify for another."
A Yes.
Q I wanted to make one more reference. I think you still may have in your possession a copy of the prehearing statement that BellSouth referenced earlier.
A Yes, I have it here. Yes, I have it.
Q Okay. And I'm looking at Page, the bottom of Page 5.
A Okay.
Q And you state here that FDN recommends a maximum of 120-day tariff duration and a maximum one-year discount eligibility with the requirement of at least one year off discount period per customer; correct?
A Yes.
Q Okay. I'm not sure -- could you just -- it seems to be there's some conflict in what's been stated. Can you just clarify what FDN's position is on the duration of the promotional tariffs and the duration of BellSouth's contracts and the waiting period associated with that for an eligible customer?

A Yes. I think that this is -- we tried to tie it out to the testimony, but it ties by saying the maximum should be 120 days of, you know, duration. So four months versus the six months. And then if you are going to sign customers up, that they should only be, you know, eligible or they should only get a year contract versus a three-year deal, and that that, that customer shouldn't be able to be perpetually just rolled over, that there should be sort of a waiting period at the end of that one year.

Q So you're basically recommending that it be any period between zero and 120 days?

A Yes. That's exactly right. I mean, obviously we'd like to see it less.

Q Okay. I want to make reference to the protest that FDN filed in Docket Number 020119. And this is a July 18, 2002, protest letter that FDN filed in this docket. I don't know if you have a copy. If you need a copy, I can provide you with one.

A Okay. I think I remember the letter, but I don't have a copy.

Q Okay. I think you can answer this question without having a copy of it.

One -- and I guess I would note that that same docket has since then been consolidated with the other two dockets which are in the proceeding today.

CHAIRMAN JABER: Move the mike a little closer.

BY MS. BANKS:

Q Okay. Can you hear me, Mr. Gallagher, okay?

A Yes.

Q Referencing Page 5 of this protest letter in which FDN is requesting that the Commission bar BellSouth from contacting a customer who ported to another carrier in an effort to regain the customer for at least 30 days after the port out period. Are you familiar with that request generally?

A Yes.

Q Okay. It has been stated and it is, has been made known that BellSouth has voluntarily established a ten-day waiting period whereby it will not initiate any win-back activities to regain a customer.

Can you just explain why FDN would need an additional 20 days prior to BellSouth initiating any win-back activities?

A We just -- ten days isn't really enough to get to know the customer. There could be some post-cut over hiccup that happened; the customer might still be blaming us for that, whether it was our fault or not. It's just, just a time to get to know the customer and try to establish some goodwill. That's really all that is.

MS. BANKS: If you'd give me one moment, Mr. Gallagher.

Staff has no further questions. Thank you, Mr. Gallagher.

CHAIRMAN JABER: Okay. Commissioners, do you have questions?

COMMISSIONER DAVIDSON: A couple of questions, Chairman. Thank you.

CHAIRMAN JABER: Go ahead.

COMMISSIONER DAVIDSON: Mr. Gallagher, first, thanks for, thanks for being here.

Is there any market-based barrier to keep Florida Digital from, and I'll use this term loosely because it's what the parties have used, locking in customers for the same period of time that BellSouth is allegedly locking in customers?

THE WITNESS: Is there a market-based? Only that some customers have preferences that they don't like long-term contracts and some, some are okay with them. So I would say, no, there's probably not a market-based, other than an individual customer preference.

COMMISSIONER DAVIDSON: You suggested in your, in your direct that you put out on the table the idea of possibly adjusting FDN's termination liability if BellSouth adjusted theirs. And I'd like, if you can, on this first go-round a yes or no answer to the following question, and then there will be some follow-up.

Is it Florida Digital's position that FDN can provide for a certain type of termination liability but BellSouth cannot provide that same termination liability?

THE WITNESS: Yes.

COMMISSIONER DAVIDSON: Okay. Follow-up question. What is your basis for making, for answering yes?

THE WITNESS: Just sheer market power. Just sheer market domination or market power.

COMMISSIONER DAVIDSON: Okay. Thanks, Chairman. That's all I have.

COMMISSIONER JABER: That's all? Commissioners, any other questions?

Okay. Redirect.

REDIRECT EXAMINATION

BY MR. FEIL:

Q Ms. Mays asked you questions with regard to FDN prices. Do you recall those questions?

A Yes.

Q Can FDN respond in price to BellSouth's Key Customer prices?

A Right.

Q Can FDN do that?

A We don't think we can be viable pricing at that, at that level, no.

Q And Ms. Mays asked you a question regarding a September 2002 tariff change regarding individual case pricing. Do you recall those questions?

A Yes.

Q Is that something that FDN does often or is it something that you merely reserve the right to do?

A We reserve the right to do it in very infrequent cases.

Q Ms. Mays asked you whether or not or asked you a few questions regarding the 20 to 30 lines FDN had an on experimental basis used resale for. Do you recall that?

A Yes.

Q Does FDN think that it can build a business model based on that 20- to 30-line experiment?

A No.

Q Why is that?

A Because there's negative margin in resale, we believe.

Q Ms. Mays asked you a question regarding FDN termination liability and handed you or referred you to an interrogatory response where you said that FDN cannot price its termination liability so high that customers would shy away. Do you recall that?

A Yes.

Q Does the reputation of an ALEC in the business community have an effect on the termination liability that an ALEC can set?

A Yes.

Q And what is that effect? How does that work?
A It really relates to how strong the customer thinks the ALEC is regarding collections. And they might be willing to sign up for a termination liability for a small player, but for a big player like BellSouth, they're very concerned about getting out of that termination liability and basically getting hunted down and forced to pay.
Q Does the level of the termination liability of the ALEC also play a role?
A Yes.
Q And how does that, how does that play a role in the business community?
A It tends to, to -- the customers are, that I've talked to, do not want to take on BellSouth and try to exit the contract. They're going -- typically tend to stay in the contract.
Q If FDN assessed a termination liability of $10,000, how would that bode for FDN's prospects in the business community?
A We'd have a hard time collecting that.
Q Would you be able to sell your product with that sort of termination liability?
A Not if it was advertised that way up front, no.
Q I wanted to hand you an exhibit. Ms., Ms. Mays talked to you about what I refer to as split service where a

customer can have one line with BellSouth and move other lines to ALECs.

What I want to refer you to, Mr. Gallagher, is Mr. Casey's prefiled testimony, his Exhibit JPC-1.

A Yes.

Q Looking at JPC-1, what does that first page show or appear to be to you?

A It's the Key, Key Customer tariff.

Q And does Paragraph 56 of that Key Customer page indicate that a customer can have split service and move to an ALEC?

A No.

Q What does it say?

A It says, "In the event the subscriber discontinues business local service with BellSouth prior to the expiration of the term, subscriber shall pay to BellSouth the amount of discounted charges for its local service and that the subscriber had received as a result of subscriber's participation in the program. In addition, subscriber shall pay to BellSouth the amount of $100 representing the cost of administration and acquisition incurred by BellSouth."

Q Could you turn to the next page, please, Mr. Gallagher?

A Yes.

Q And what is on that next page?

A It's more Key Customer tariff.

Q Could you look at Paragraph Number 5 on that page and tell me whether or not that indicates to you that a customer could have split service?

A No. It's -- again, it's a termination liability paragraph.

Q When Ms. Mays walked you through the hypothetical regarding the proposition of BellSouth discounting to all customers in her hypothetical -- do you recall, do you recall that line of questioning?

A Yes.

Q Is it FDN's proposal in this case that the exact level of the Key Customer discount be provided to all customers?

A No.

Q Could it be at some other level?

A Yes.

Q You mentioned, when Ms. Mays was asking you questions, I believe, and also when Ms. Banks was asking you questions, about other states.

Do you have colleagues in other states and have you received information from them regarding what's going on in other states on win-backs?

A Yes.

Q Okay. What, what have you heard?

A Well, up north it just doesn't happen. In the Verizon states, in New York, in Pennsylvania, in Massachusetts, it never, it never gets filed. And I'm just -- I've just looked at the states that have it. It just seems to be a -- you know, I'm a southerner. But it seems to be only in the southern states. There is some limited exceptions to that.

But I, I don't, I don't know why those commissions up there don't think that these are appropriate other than they, you know, maybe, maybe believe, like we do, that the competition is in a nascent state at this point and that there will be a time for that, but it's just not now.

Q Ms. Mays asked you some questions about FDN's line growth. Do you recall those?

A Yes.

Q Could you explain the role of churn in looking at line growth statistics?

A Yes. Churn is -- well, in line growth you're obviously trying to get to a net number, which would be the -- your additions less your losses would equal your net, your net line growth.

Q Okay. What impact does churn have on your ALEC?

A We experience churn related to the similar things that BellSouth does for when a customer might disconnect for going out of business, but we also experience it for customers that port away from us going back to BellSouth.

Q Ms. Mays asked you a few questions regarding BellSouth's Key Customer programs of old. I wanted to hand you some of the tariffs of BellSouth's prior Key Customer programs.

(Pause.)

MR. FEIL: Madam Chair, if I may have the next exhibit number. I think this can be a composite.

CHAIRMAN JABER: Can you give me a short title, please?

MR. FEIL: Pre-2002 Key Customer tariffs.

CHAIRMAN JABER: Pre-2002 Key Customer tariffs are identified as a composite Exhibit 11.

(Exhibit Number 11 marked for identification.)

BY MR. FEIL:

Q Mr. Gallagher, in looking at these, these two tariff packages, are the discount levels that BellSouth offered under these prior tariffs the same as what they offer under the 2002 Key Customer tariffs?

A No. They differ significantly in that the base discount isn't -- you know, in the case of the one, the, the tariff, the 2000 tariff, the base, the max discount is 16 percent and as little as eight percent, and there's no free hunting. And the termination liability was different in these tariffs as well. It was easier for the customers to get out.

And also in the, in the second one, there is a max discount again of 16 percent and there is no free hunting.

Again, hunting used to be a $12 feature, then it was $10. It's $10 right now. So $10 per line is a significant chunk of, of the, you know, discount.

Q Mr. Gallagher, I'm looking at both of these tariff sheets and I don't see anything regarding termination liability. Did you see anything regarding termination liability?

A No, I did not read that. I just remember that these ones were not -- our sales force did not view these as onerous regarding termination liability and our marketing department did not alert me to that. So I assumed it was a fairly small termination liability, if any.

Q Is the maximum discount here generally above or generally below FDN's standard rates?

A The discount of 16 percent would be -- if FDN's average is 20 percent, it would be, the discount would be below our discount.

Q I'm sorry. What was that? The discount what?

A The discount of 16 percent is less than our discount of 20 percent.

Q You mentioned when Ms. Mays was asking you some questions about EBITDA positive, free cash flow positive and profitability.

A Right.

Q Could you distinguish for me those three briefly?

A Yes. EBITDA positive is earnings before interest taxes depreciation amortization. It is a common benchmark for heavily asset-driven companies. And FDN is EBITDA positive. Below EBITDA there are other cash-consuming line items, but there are also some non-cash-consuming. Below EBITDA, things that consume cash are interest expense and capital expenditures.

FDN still has to finance our capital expenditures in some way because we can't, we can't -- we don't make enough money to afford new equipment to put in COs or new fiber-optic gear or new switch ports. So when we say we're EBITDA positive, people like Ms. Garcia down at the Miami Herald sometimes construe that as profitable.

We hope to be profitable. We hoped to be profitable in 2002. We were not due to some slowed growth. And we -- depending on how much capital expenditures we decide to spend in a month, we can make ourselves cash flow positive for a month. But then when we have to go buy network and equipment, we either have to finance that via a third party or we just don't buy it.

CHAIRMAN JABER: Can you get venture capital financing and alternative financing only because you're EBITDA positive?

THE WITNESS: Yes. In our industry right now, if you're not EBITDA positive, you have no chance of getting financed. And we're going to sell off a chunk of our company to raise cash to pay for this Mpower acquisition. So that's how we're financing it via venture capital sale of a piece of our company to raise the cash to do that.

CHAIRMAN JABER: And how does the EBITDA positive come into the FCC's evaluation of a competitive market? Does it?

THE WITNESS: I don't know that it does. I don't think that they look at that. They just look at numbers of competitors and numbers of switches and numbers of routes.

CHAIRMAN JABER: Should it?

THE WITNESS: You know, I just -- part of me says is that really the government's job to, to run people's businesses for them? But the health of an industry should be noted somehow.

CHAIRMAN JABER: Well, as we consider at a state level the health of the telecom industry, the fact that companies may be EBITDA positive but not cash flow positive, how should we take that into account?

THE WITNESS: Well, it's very interesting in light of what could happen tomorrow.

If UNE-P is, is given life, then theoretically we would not, we could choose to not invest anymore money in our network and just sign people up UNE-P. Then, therefore, we would be not needing to use capital below the line, below the

EBITDA line.

We actually agree with BellSouth, believe it or not, in the case that it does disincent us to invest anymore in our network if UNE-P is kept around. So we're sort of a little confused by that whole thing right now ourselves.

COMMISSIONER JABER: There were some questions from the telecommunications reports and let me just say to all of you, I appreciate the compliments. But we don't -- we also don't take personally the criticism as it relates to the report. It is an evolving project in terms of making the report more accurate and useful. And I find myself wondering if there needs to be some discussion now in the report about companies being EBITDA positive and, versus cash flow positive.

THE WITNESS: Right. Right.

CHAIRMAN JABER: Is that something as a competitor you think would be useful? I know as it relates to the universal service fund we're looking at EBITDA statistics.

THE WITNESS: I think so. I do. Because I think it's important to, to know that the underlying health of the industry and whether or not it's a temporary phenomenon, whether or not it's a sustainable, sustainable industry.

CHAIRMAN JABER: Mr. Feil, I'm sorry. I interrupted you.

MR. FEIL: Thank you.

CHAIRMAN JABER: Commissioner Deason?

COMMISSIONER DEASON: While -- I have a question while we're at this stage.

I'm referring to composite Exhibit Number 9 and the September 9th Miami Herald article where you're quoted as saying, "We're now debt free and profitable." What did you mean by "profitable" in that setting?

THE WITNESS: I'm pretty sure that I said EBITDA positive and explained it. And I think what happens sometimes is you're quoted differently from what you said.

I would, I would expect that, that -- you know, we've never represented that we're net income positive, which is by definition profitable.

BY MR. FEIL:

Q So, so we clarify the record, at the end of 2002, FDN was or was not EBITDA positive?

A At the end of 2002 we were EBITDA positive.

Q And at the end of 2002, free cash flow positive?

A Right at the brink, depending on how much equipment we, we determined to invest in that month.

Q Profitable, was it profitable?

A No, not, not net income profitable.

Q Does the Key Customer program in BellSouth's promotional discounts influence whether or not FDN is EBITDA positive, free cash flow, free cash flow positive or profitable?

A Yes. Because we expected to get to profitability or net income positive earlier because we thought we could grow at the same rate we'd been growing in the past, and that has not happened.

Q Does the Key Customer program influence FDN's capital decisions?

A Yes, it does.

Q How?

A We're at, very much at a crossroads both with this, the decision of this Commission on this tariff and with the FCC's decision on basically how to compete going forward: Whether or not we should use our scarce capital to invest in network, invest in sales people or go into more of a hibernation mode and try to protect the customer base.

Q Does FDN favor moving its business model to a UNE-P business model?

A No.

Q Why?

A Only because I believe in the end that, that UNE-P will be regulated away. And I just would like to be ahead of where things are going. And, to me, our model is the sustainable model for competition.

We, we also innovate a lot more. And I think it's important for the Commission to know there's things we do for our customers that UNE-P people can't do. We, we allow 7-digit dialing. We'll stuff the 407 into, to the number for an Orlando customer, for example. We've done some things with DSL that customers really like. We've created this IDSL product that's not that fast but it works everywhere, it's ubiquitous. So customers like that. We have -- we allow customers, you know, a small business that has multiple locations in the state to call other locations for virtually free.

So we're able to do things with our switches and our network and our fiber that, that innovate with the loop. And I think that was the real, the real cause behind the Telecom Act to create access to that loop and let competitors try to innovate with it. So that's why that I think in the end UNE-P, while a good entry strategy, is not a long-term model.

Q Ms. Banks asked you a question regarding hot wire centers and whether or not discounts were available in hot wire centers. And I believe part of your answer was it was theoretically available to all customers in the hot wire center. Why did you say "theoretically available"?

A Well, you won't know about it unless you're contacted by a customer or by a competitor typically. There's limited advertising and it's typically offered in a response to a competitive overture.

Q I wanted to ask you a follow-up question to something Ms. Mays asked you. She referred you to your answer to staff Interrogatory 5A. Do you have that in front of you?

A I believe so.

Q She handed you one page of that; is that correct?

A Yes. I have the, I have the page.

Q Is there more than one page of that?

A I think there is, yes.

Q And in the situation she was discussing where the customer had wanted to, or it was a partial port and the customer was going to leave one line with BellSouth, what was on that line?

A DSL. We're unable to -- we're working, we're trying to work it through our last arbitration here, but at this point the customer has to leave one line with BellSouth, and that's where the DSL lives.

Q So are you saying that at that time the customer could not have migrated that line?

A That's correct.

MR. FEIL: May I have a moment, Madam Chair? I may be done.

CHAIRMAN JABER: Sure. Sure.

MR. FEIL: I am finished. Thank you.

CHAIRMAN JABER: You said you were finished? You said you were finished?

MR. FEIL: Yes, ma'am, I'm done.

CHAIRMAN JABER: Thank you. Exhibits, we have Exhibits 6 and 7, FDN, that are yours. 6, 7 and 11 are yours.

MR. FEIL: Yes, ma'am. I would move those into the record, with the clarification that MPG-1 included within 6 is the November 7th filed version.

CHAIRMAN JABER: Thank you. Without objection, Exhibit 6, 7 and 11 are admitted into the record.

(Exhibit Numbers 6, 7 and 11 admitted into the record.)

CHAIRMAN JABER: BellSouth, Exhibits 8, 9 and 10 are yours?

MS. MAYS: Yes, Madam Chair. We would ask that those also be included.

CHAIRMAN JABER: Without objection, Exhibits 8, 9 and 10 are admitted into the record.

(Exhibit Numbers 8, 9 and 10 admitted into the record.)

MS. MAYS: Madam Chair, if I may, there were two interrogatory responses that were confidential that FDN provided to us and did not want to get into the confidential data. I would like to have those two discovery responses admitted into the record under the normal confidentiality treatment. And I have copies if that's --

CHAIRMAN JABER: They weren't part of staff's composite exhibit?

MS. MAYS: They were not. These were responses to

BellSouth's discovery, not to staff.

CHAIRMAN JABER: Have you all reached agreement on that?

MR. FEIL: I'm not exactly sure which specific one she is identifying. But if you want -- well, I don't know whether or not you were going to take a break.

CHAIRMAN JABER: Yeah. Ms. Mays, why don't we do this. Rather than discuss it on the record, since they are confidential in nature, why don't I -- during a lunch break you and Mr. Feil just compare the exhibit and discuss how you want to handle it. My preference is that it come in as a stipulation, if you all can.

MS. MAYS: Okay.

CHAIRMAN JABER: Because we haven't -- you haven't cross-examined -- well, we haven't seen the exhibit during your cross-examination, so.

MS. MAYS: That's fine.

CHAIRMAN JABER: Okay.

COMMISSIONER DAVIDSON: Chairman, I have a question of the --

CHAIRMAN JABER: Of?

COMMISSIONER DAVIDSON: Of the witness.

CHAIRMAN JABER: Well, we just closed this part. I'd have to allow redirect, but we can.

MR. FEIL: I don't have an objection.

COMMISSIONER DAVIDSON: Okay. Well, never mind.

CHAIRMAN JABER: Okay. Are you sure, Commissioner, because Mr. Feil has agreed to --

MR. FEIL: I don't have an objection if he has a question.

COMMISSIONER DAVIDSON: Thanks. It's a, hopefully a short question.

You stated, Mr. Gallagher, that FDN could not sell new product with the same termination liability that BellSouth uses in the same way. And I -- if, if you could -- I'm just curious, what, what -- if you could summarize the differences that would allow BellSouth to effectively sell with the termination liability that, what's different for FDN.

THE WITNESS: That's a good question. We theoretically could do it. We probably would prefer not to do it. But we, we could sell that way. We have limited market power, I guess. So we just, we just aren't as, as strong, I would say, to be able to, to, to, to do that.

CHAIRMAN JABER: Mr. Feil, any --

MR. FEIL: No, ma'am. No follow-up.

CHAIRMAN JABER: Thank you. Okay. Mr. Gallagher, thank you for testifying today.

THE WITNESS: Thank you.

(Transcript continues in sequence with Volume 2.)

STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, LINDA BOLES, RPR, Official Commission Reporter, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

I FURTHER CERTIFY that I am not a relative, employee, attorney or counsel of any of the parties, nor am I a relative or employee of any of the parties' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 26th DAY OF FEBRUARY, 2003.

Linda Boles

LINDA BOLES, RPR
FPSC Official Commissioner Reporter
(850) 413-6734