BELLSOUTH TELECOMMUNICATIONS, INC.

REBUTTAL TESTIMONY OF DR. CHRISTOPHER JON PLEATSIKAS

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 030851-TP

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I. INTRODUCTION

Q. ARE YOU THE SAME CHRISTOPHER JON PLEATSIKAS WHO FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My rebuttal testimony responds to the economic arguments regarding market definition made by Dr. Mark T. Bryant on behalf of MCI, Dr. Brian K. Staihr on behalf of Sprint, and Mr. Joseph Gillan on behalf of the Florida Competitive Carriers Association ("FCCA").

II. RESPONSE TO DR. BRYANT

Q. PLEASE DESCRIBE DR. BRYANT'S MARKET DEFINITION RECOMMENDATION.

A. In his direct testimony, Dr. Bryant concludes that each customer location represents a unique market. (Bryant Direct 40, 42) Dr. Bryant notes that for administrative convenience, the Commission may aggregate these "individual markets" to the wire center level. (Bryant Direct 43)

Q. IS EACH CUSTOMER LOCATION A UNIQUE MARKET?

A. No. In his direct testimony, Dr. Bryant based his proposed market definition merely on the observation that a customer wants landline telephone service at his or her location, and his assertion that having telephone service available at another (even nearby) location is not a substitute. (Bryant Direct 40) This is neither an accurate characterization of the demand for telecommunications services nor does it comply with the FCC's requirement, and basic economics, that a market definition consider whether a firm serving only one area could take advantage of the available scale and scope economies that might be available by serving a wider market. (TRO fn. 1536)

Dr. Bryant's observation that customers want telephone service in their own homes or businesses and that service to other locations is an inadequate substitute, is an observation focused solely on demand-side substitutability, whereas markets should be defined with reference to both demand-side and supply-side substitutability. That is, you have to look at the market definition not solely from the viewpoint of the person receiving the service, but from the viewpoint of the person providing the service. Moreover, even ignoring supply-side substitutability, as a general economic proposition in terms of the demand for telecommunications services, advances in technology have undermined the validity and applicability of Dr. Bryant's views on demand-side substitutability, including for the purpose of defining geographic markets. For example, the provision and use of telecommunications services via wireless (i.e., mobile) technology demonstrates that, for some end users in at least some circumstances, the customers' premises is not the only geographic location at which customers desire or accept delivery of telecommunications services.

In discussing the issue of market definition, the FCC recognizes the importance of supply considerations, that is, looking at the market definition from the viewpoint of the supplier of the service. The FCC specifically instructs state commissions on this issue:

> We make clear that state commissions cannot define a market as encompassing an entire state and that they should not define the market so narrowly that a competitor serving that market alone would not be able to take advantage of available scale and scope economies from serving a wider market. (TRO fn. 1536)

Dr. Bryant's direct testimony on proposed market definition does not consider the FCC's requirement that the market definition incorporate relevant supply considerations, and as a result his definition fails to meet the FCC's expectations that "one would expect a broader market definition for switching than for loops or transport." (TRO fn. 1536)

Q. PLEASE COMMENT ON DR. BRYANT'S ARGUMENT THAT "A MARKET DEFINITION THAT IGNORED LOCATION SPECIFICITY WOULD FLY IN THE FACE OF THE ENTIRE FOUNDATION OF ANTITRUST AND REGULATORY ECONOMICS." (BRYANT DIRECT 42)

A. I agree that location specificity can be an important aspect of a product or service. However, location specificity in demand, by itself, is insufficient to imply that each individual location is a separate market. As I described, location specificity in demand for (landline) telecommunications services is related to a particular existing delivery technology as much as, or possibly more than, customer demand. In any event, location specificity is not unique to telecommunications services. There are other products that provide location specific services, but, like telecommunications, one cannot infer from this alone that each location is a separate market.

To illustrate how Dr. Bryant ignores the supply side of the definition of a market, consider "house painting." House painting is location specific in demand because, using Dr. Bryant's characterization, having the service "delivered" to a neighbor's house is not an adequate substitute for having your own house painted. Yet, each individual home does not constitute a separate market because most firms that provide house painting services (other than an atypical and idiosyncratic "firm," such as a teenager who wants only to paint a parent's or neighbor's house) would not organize themselves so as to serve only one particular home. As the FCC instructs, available scale and/or scope economies (e.g., that can be captured through ladders, scaffolding, and other capital supplies or advertising one's services in the Yellow Pages), among other factors affecting supply substitutability, imply that the geographic market for house painting is larger than a single-house location.

Q. DOES DR. BRYANT CONCLUDE THAT CUSTOMER LOCATIONS ARE MARKETS?

A. No, in his direct testimony, Dr. Bryant confusingly suggests that although customer locations are apparently "the relevant geographical market for local telecommunications services" (p. 43), there are several "factors that support a market definition at the wire-center level" (p. 45) and so it is "most practical to conduct impairment analysis at the wire-center level" (p.46). In short, Dr. Bryant seemingly cannot decide whether he prefers customer locations or wire-centers as a market definition. In my opinion, neither of these definitions meets the guidance in the TRO.

Q. YOU HAVE DEMONSTRATED THAT CUSTOMER LOCATIONS ARE NOT MARKETS. IS DR. BRYANT'S WIRE CENTER AGGREGATION ANY MORE REASONABLE?

A. No, his aggregation is not reasonable because it does not sufficiently consider substitutability in supply. That is, it fails to consider whether efficient competitors using self-provisioned (or third-party) switching to provide service in certain wire centers could, within a sufficiently short period of time, render supracompetitive pricing by the incumbent in another, proximate wire center unprofitable (i.e., because a sufficient number of the incumbent's customers would switch to one of the competitors in response to such pricing). If these competitors could do so, then the relevant geographic market *must be larger than the individual wire center*. In fact, the scale and scope economies available to efficient entrants (TRO fn. 1536) are generally not consistent with the existence of narrow geographic markets defined along wire center boundaries. These scale and scope economies, which exist in part because of similarities in certain costs and demand and other economic characteristics shared by groupings of proximate wire centers, facilitate competition across broader geographic areas than individual wire centers.

Wire centers were organized years ago to efficiently permit the ILEC to serve all customer locations using the technology of the day. With (1) the continued growth of competition, and with each competitor (and the ILEC) serving fewer than the total number of customer lines in a wire center; (2) technological change that permits carriers economically to serve multiple wire centers using a single switch rather than replicate the traditional network; and (3) the use by at least some CLECs of mass media advertising to attract customers (e.g., Z-Tel), single wire centers do not adequately reflect substitutability in supply and therefore are not markets.

Q. DO COLLOCATION COSTS BY THEMSELVES DEFINE A MARKET?

A. No. Collocation costs can influence where a CLEC may seek to offer service in a market, but they do not, by themselves, determine the geographic scope of the market. As I noted earlier, the geographic scope of a market is defined by considering *both* demand and supply substitutability.

That is, the issue for market definition in the context of this proceeding is whether, given demand and supply substitutability, an efficient competitor serving one part of an area reasonably could serve another part, recognizing that in so doing it could incur additional costs such as additional collocation costs in the event that it is not already collocated. Dr. Bryant contends that CLECs make such decisions on a wire center-by-wire center basis because costs vary across wire centers. (Bryant Direct 43) However, most CLECs that provided information on this point stated, contrary to Dr. Bryant's assertion, that they do not make entry decisions at the wire center level. (FCCA Response to BellSouth Interrogatory 1-18) Moreover, while it is true that certain costs vary across different wire centers, the "zoning" concept for UNE prices is intended to address, at least in part, this specific issue by identifying wire centers with similar cost characteristics. More importantly, when the wire centers in a geographic area share certain cost and other economic characteristics, an efficient CLEC that operates in one part of the market (e.g., serves customers in one wire center) would generally be able to increase its profit (e.g., because it could spread the recovery of joint and common overhead costs across more customers) by extending its services to customers in other nearby areas (i.e., whose loops are in other similarly situated wire centers). In other words, if providing service in one wire center is likely to be profitable, then providing service in another proximate wire center that has similar costs and shares other economic commonalities is likely to be profitable as well. As I noted, providing service in new areas of this overall market may require an outlay for additional collocation cost, but this is merely one of the costs of doing business—it is not the sole determinant of market definition.

Dr. Bryant has not demonstrated either that efficient CLECs make entry decisions in the manner he asserts or that demand and supply substitutability would generally result in geographic markets confined to wire center boundaries. To the contrary, the ability of CLECs to capture economies of scope and scale across a wider area because aggregations of wire centers share certain cost and other economic characteristics is inconsistent with Dr. Bryant's assertions. In deriving my market definition as the intersection of UNE Zones and Component Economic Areas I specifically considered factors relating to both homogeneity in certain costs and economic commonality, both of which affect supply substitutability.

Q. DID ANY CLECS SUPPORT A CLAIM TO CONSIDER ENTRY DECISIONS ON A WIRE CENTER-BY-WIRE CENTER BASIS?

A. No. In its response to BellSouth's first set of interrogatories, the FCCA notes that 2 of 9 CLECs that the FCCA interviewed claimed to make decisions to "enter a market at the wire-center level." (FCCA Response to BellSouth Interrogatory 1-18) However, when given the opportunity to identify the factors that influence its market entry decisions, one of those two CLECs, MCI, listed ILEC retail prices, ILEC access charges, and ILEC UNE-P/UNE pricing—none of which is determined solely at the level of the wire center. Indeed, ILEC retail prices, ILEC access charges, and ILEC UNE-P/UNE pricing extend across multiple wire centers. The other CLEC that claimed to make entry decisions at the wire center level, Network Telephone, stated that it would not enter additional wire centers due to the regulatory climate and an unfavorable capital market. (FCCA Response to BellSouth Interrogatory 1-19) Neither of these factors is affected by developments at the level of wire center boundaries.

Q. DR. BRYANT MAINTAINS THAT CLECS WILL NOT OFFER SERVICE IN A PARTICULAR WIRE CENTER IF THEY DO NOT BELIEVE THAT THE WIRE CENTER WILL "CONTRIBUTE TO THE BOTTOM LINE." (BRYANT DIRECT 48-49) IF TRUE, DOES THIS IMPLY THAT EACH WIRE CENTER REPRESENTS A DIFFERENT MARKET?

A. No, Dr. Bryant's perspective is too simplistic in that it ignores both the import of the concept of substitutability in supply and the manner by which firms evaluate and exploit business opportunities. For example, if a firm were to analyze the profitability of entry into a single wire center in isolation from the opportunities available in contiguous and/or proximate wire centers, it might find that entry was likely to be unprofitable given all of the costs associated with entry. By contrast, if at least some such costs (such as switching, marketing and administrative costs) could be amortized over multiple wire centers, entry might be highly profitable over a broader area. Of course, firms use the latter method for evaluating opportunities – by assessing financial and economic viability over reasonably-sized geographic (and product) spaces, not by artificially confining themselves to providing services within arbitrarily defined narrow areas (such as individual wire center boundaries) that have no relevance to their business models. Thus, the rational CLEC selects the geographic area – which likely includes several wire centers – that maximizes its profits. Insofar as there are economies of scale and scope that are captured by serving multiple wire centers, the rational CLEC will ultimately enter and serve an area that spans that broader geography.

Wire centers that have the similar cost and revenue characteristics can be grouped together because either (1) the efficient CLEC that decides to enter one wire center due to its perceived profitability would be willing (and able) economically to enter another nearby wire center with similar cost characteristics and market prospects and/or (2) the efficient CLEC may initially decide to enter multiple wire centers (either sequentially or simultaneously) if it believes that serving the combination of wire centers is likely to be profitable even if serving any of the wire centers individually (in isolation) would not be profitable. Because a CLEC can use some of its assets (e.g., the switch) to serve customers in a broader area, economies of scale and scope associated with those assets are relevant to determining the market definition.

Indeed, this is precisely the relevance of my proposal for defining a market as the intersection of the UNE Zones in BellSouth's territory with the relevant Component Economic Area ("CEA"). The UNE Zone/CEA intersection identifies those relatively compact areas that are economically related and where costs are relatively homogeneous. These areas are reasonably likely to correspond to the market area considered by the CLEC in deciding whether to enter.

Q. IS THE ACTUAL COVERAGE OF FACILITIES-BASED CLECS AN INDICATOR OF THE GEOGRAPHIC MARKET AREA?

A. In the case of telecommunications, no, due to the impact that widespread availability of UNE-P has on facilities deployment. The extent of coverage offered by a service provider can be one indicator of the geographic scope of the market. However, as is noted by FCC Chairman Michael Powell in his Separate Statement to the TRO, the situation is different in telecommunications because there may be an incentive in at least some circumstances for CLECs to use UNE-P rather than self-provided or third-party switching even in instances where there is no impairment. Mr. Powell contends that the availability of UNE-P entices CLECs to use that method of service even when they economically could serve customers using UNE-L. As Dr. Aron describes, this can occur because UNE-P provides the promise of higher profits than UNE-L and/or the use of UNE-P permits CLECs to offer service without making risky, irreversible investments in switching infrastructure.

As a result, if we observe a CLEC that offers mass-market service from its own switch to customers in a relatively compact, economically meaningful, area (such as a UNE Zone within a CEA) that is served by multiple wire centers, we can conclude that the relevant geographic market is broader than a single wire center. However, we cannot necessarily conclude that we have observed the full scope of the UNE-L marketplace just from the current deployment of UNE-L (i.e., because the real-world CLEC's business plan may be influenced by the availability of UNE-P). For this reason, it is more appropriate to consider aggregations of wire centers, such as the UNE Zone/CEA method that I propose. This approach identifies relatively (geographically) compact areas that are economically related and where costs are relatively homogeneous. If an efficient CLEC economically can offer service in one part of the area without access to the unbundled element, it may well be able to offer service in any other part of that area, even if, in the real world, this capability is being obscured by CLECs' choice of UNE-P rather than self-provisioning of switching.

Furthermore, the evidence provided by BellSouth witness Pam Tipton demonstrates that CLEC switches generally provide service across multiple wire centers. Moreover, as Z-Tel's witness Michael Reith testifies, that firm advertises in media such as television, radio, and print that cross wire center boundaries. As a matter of economics, this evidence is inconsistent with Dr. Bryant's proposed market definition.

Q. DR. BRYANT CLAIMS THAT THE CONNECTICUT DEPARTMENT OF PUBLIC UTILITY CONTROL ALREADY HAS DETERMINED THAT THE WIRE CENTER IS THE APPROPRIATE UNIT OF ANALYSIS. (BRYANT DIRECT 49) PLEASE COMMENT.

A. As I understand it, the CDPUC in its procedural order stated that it would collect data at the wire center level, but that it has not yet made a substantive determination with regard to market definition. For example, in response to a petition for clarification and reconsideration filed by Southern New England Telephone Company, the CDPUC affirmed that it will use the wire center as the basis for collecting data and for its preliminary analysis. However, in that response, the CDPUC acknowledged that it had not made a final determination about market definition by concluding, "Nevertheless, such designation [of wire centers for purposes of collecting data] does not prevent the Department from utilizing other market measurement points if they are necessary or beneficial to its efforts in defining the extent of competitive participation in the local exchange market."

Q. DR. BRYANT CLAIMS THAT WIRE CENTERS ARE NATURAL GEOGRAPHIC BOUNDARIES BECAUSE COSTS VARY WIDELY ACROSS WIRE CENTERS. (BRYANT DIRECT 29) PLEASE COMMENT.

A. Even though costs may vary across wire centers, this does not necessarily imply that wire centers are relevant markets. The reason that the one does not imply the other is, as I noted earlier, that an efficient CLEC would not seek to enter only one particular wire center without also evaluating whether it would be more profitable (due to economies of scale or scope) to enter a broader group of wire centers that have comparable (but not necessarily exactly the same) costs and are economically related. Generally, if we observe CLEC entry in one wire center, we can infer that efficient CLEC can enter other nearby, similarly situated, wire centers. Indeed, as I discussed, there may be cases where it would not be economical to enter only one wire center *without* also (ultimately) entering others, due to the existence of certain joint and/or common costs that are relevant to providing service to multiple individual wire centers.

As I noted, UNE Rate Zones are intended distinguish between "significant cost variations." (FCC First Report and Order at ¶¶ 760, 765) The FCC also noted that the state commission should consider separating zones with high and low UNE loop rates for purposes of assessing impairment. (TRO fn. 1538) Moreover, I also understand that this Commission has grouped wire centers into UNE Rate Zones that have similar cost characteristics. It follows that Dr. Bryant's contention that it is "not possible [to] draw conclusions about one wire center from an analysis of another wire center" (Bryant Direct 86) is unsupported by this Commission's own conclusions with regard to UNE Zones. (Florida Order PSC-01-1181-FOF-TP, May 2001) In fact, the opposite is the case: it is reasonable for the purpose of defining a geographic market to draw inferences about the ability of an efficient CLEC to serve in one area of a UNE Zone/CEA from observations of CLEC service in other areas of that UNE Zone/CEA.

Q. PLEASE COMMENT ON DR. BRYANT'S ASSERTION THAT IT IS LESS COSTLY FOR A CLEC TO SERVE NEW CUSTOMERS IN A WIRE CENTER WHERE THE CLEC ALREADY IS COLLOCATED THAN IT IS TO SERVE NEW CUSTOMERS IN A WIRE CENTER WHERE THE CLEC HAS NOT YET ESTABLISHED COLLOCATION. (BRYANT DIRECT 29)

A. Even if this assertion is true, it is not necessarily directly relevant to market definition. To understand this, consider the following observation. A publishing firm may find that it is less costly (and more profitable) to sell cookbooks to customers that already subscribe to the firm's homeowner's magazine than to new customers (i.e., people to whom the firm currently sell no products). This may occur for several reasons – e.g., the firm understands the tastes and needs of current subscribers, the current subscribers have developed a level of trust in and/or a preference for the firm's products, and/or it is relatively less expensive to market the cookbook to current subscribers (for example, through an advertising insert that could be included in the magazine at relatively low incremental cost). As a result, the firm's costs of sales may be much lower (and the firm's success rate as measured by sales per contact much higher) to its existing magazine subscribers than to new customers. Nevertheless, this does not imply that new customers are in a separate relevant market for cookbooks. A cost differential of the sort described by Dr. Bryant does not, by itself, determine the extent of the market.

Indeed, it is reasonable to infer that a CLEC that has established collocation in one wire center could establish collocation in a nearby wire center that has similar costs (e.g., the same loop rates) and that shares a close economic relationship with the collocated wire center. Moreover, it is possible that the CLEC could increase its overall profitability by collocating in the other wire center and take advantage of scale and scope economies available from serving this wider area. After all, collocation costs are not the only costs that are relevant to determining market area.

As I noted, the competitive entry decision occurs at the *market* level (which generally would span several wire centers) even if a particular CLEC may elect not to enter a *particular* wire center (immediately or ever). Accordingly, and in contrast to Dr. Bryant's proposal, a reasonable way of determining whether a particular wire center should be included in a more broadly defined market area depends on whether that wire center's relevant economic/financial characteristics are reasonably homogeneous with those of other proximate wire centers. If they are, then the wire center should generally be included in that broader market area. The UNE Rate Zone concept helps ensure that network-related costs (e.g., the price of a loop) are comparable within any geographic market. Using these zones in conjunction with CEAs to define geographic markets helps ensure that these areas are relatively compact and share certain economic characteristics.

III. RESPONSE TO DR. STAIHR

Q. PLEASE DESCRIBE DR. STAIHR'S RECOMMENDATION WITH REGARD TO GEOGRAPHIC MARKET DEFINITION.

A. Dr. Staihr recommends the use of metropolitan areas ("metropolitan statistical areas" or "MSAs") as the relevant geographic market. (Staihr Direct 4) As I noted in my direct testimony, MSAs do not collectively cover all of the geography in a state. CEAs do so. Thus, under Dr. Staihr's proposal there would be areas where impairment could not be evaluated. However, and critically, Dr. Staihr also seeks to imply, as Dr. Bryant did (see my previous answer), that plans by CLECs to serve only some customers in a market somehow necessarily has implications for defining the geographic scope of a market. (Staihr Direct 14-15).

Q. WHAT ARE THE PROBLEMS WITH DR. STAIHR'S RECOMMENDATION?

A. Dr. Staihr is concerned that a CLEC may be cherry picking by serving only part of the market. I have already noted that the target customer base of any particular firm bears no necessary relationship to defining a geographic market.

In fact, one reasonably might expect at least some (and perhaps all) CLECs to focus their network resources (to the extent that they deploy them at all) on particular customer types or geographic areas, rather than serve (or even to attempt to serve) all customers in a market. In other words, even when a market is defined properly, real-world CLECs may have incentives to target the areas (and/or customer types) where they serve mass-market customers using their own switches, and, as FCC Chairman Powell, Dr. Aron, and I have noted, they also may have incentives to refrain altogether from deploying their own switching when UNE-P is available. Thus, Dr. Staihr's implication that the extent and/or magnitude of current UNE-L service is necessarily determinative for market definition purposes is not supportable as a matter of economics.

On the other hand, dividing CEAs by UNE Rate Zones helps ensure that one has identified areas that are economically related and that are relatively homogeneous in cost. If a CLEC serves one part of that market area using its own (or a third party's) switching, one can generally infer that the CLEC, if efficient, economically could serve another part. Thus, one can accomplish the objective of defining economically meaningful geographic markets by utilizing a market definition that helps ensure that the area being considered is relatively homogeneous in terms of costs and other economic factors.

IV. RESPONSE TO MR. GILLAN

Q. PLEASE DESCRIBE MR. GILLAN'S DEFINITION OF GEOGRAPHIC MARKET.

A. Mr. Gillan claims that he does not propose a geographic market definition. (Gillan Direct 23) However, Mr. Gillan also contends that the Commission should define its geographic area in a "manner that permits [the Commission] to recognize the unique competitive signature of UNE-P, so that it may test other entry strategies to see whether they could produce the same level of competitive choice." (Gillan Direct 29) In other words, Mr. Gillan contends that the geographic market, however defined, should permit a competitive entry strategy that would replicate the same geographic pattern of market penetration that has occurred for CLECs with the use of UNE-P.

Q. PLEASE COMMENT ON MR. GILLAN'S "COMPETITIVE SIGNATURE" APPROACH TO MARKET DEFINITION.

A. I understand that Mr. Ruscilli points out that Mr. Gillan's proposal is nothing more than an attempt to define the market as the entire state, a definition that is explicitly ruled out in the TRO (¶495). From a market definition perspective, I will note that one does not define markets merely by evaluating the competitive entry strategies of individual firms. I will also note that, when provided the opportunity in the FCCA Response to BellSouth Interrogatory 1-09, Mr. Gillan identified no treatises, articles or literature addressing the "competitive signature" approach to market definition and specifically stated that his opinion relied upon no such treatises, articles or literature.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.