ORIGINAL

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY OF

JOSEPH GILLAN

ON BEHALF OF

AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.

DOCKET NOs: 960833-TP/960846-TP/971140-TP/960757-TP/960916-TP

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Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Joseph Gillan. My business address is P.O. Box 541038, Orlando, Florida 32854.

Q. WHAT IS YOUR OCCUPATION?

A. I am an economist with a consulting practice specializing in telecommunications. My clients span a range of interests and have included state public utility commissions, consumer advocate organizations, local exchange carriers, competitive access providers, and long distance companies.

Q. PLEASE BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND RELATED EXPERIENCE.

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

Regulatory Research Institute.

In 1985, I left the Commission to join U.S. Switch, a venture firm organized to develop interexchange access networks in partnership with independent local telephone companies. At the end of 1986, I resigned my position of Vice President-Marketing/Strategic Planning to begin a consulting practice. Over the past decade, I have provided testimony before more than 25 state commissions, four state legislatures, the Federal-State Joint Board on Separations Reform, and the Commerce Committee of United States Senate. I currently serve on the Advisory Council to New Mexico State University's Center for Regulation.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I am testifying on behalf of AT&T Communications of the Southern States, Inc. (AT&T).

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to touch briefly on two issues raised by BellSouth's witnesses Baeza and Varner. Perhaps with a goal of poetic balance, Mr. Varner's testimony tries to make a small issue appear large, while Mr. Baeza's testimony strives to make a very large issue seem small.

The small issue that looms large in the testimony of Mr. Varner is the claim that BellSouth must be able to recover its "residual historical costs" or the local rates for rural consumers will increase. As my testimony explains below, the danger that the rates for *any* class of customers will increase is best addressed by assuring

customers have a competitive *choice* in the future -- an objective completely at odds with Mr. Varner's recommendations. The Commission should reject BellSouth's effort to impose costs unrelated to the efficient provision of network elements on their competitors.

The large issue made small by Mr. Baeza is the use of integrated digital loop technology as the technology of choice in a forward-looking cost study. By a single sentence of his testimony, Mr. Baeza dismisses this efficient technology with a (not so) veiled reference to BellSouth's position regarding how network element combinations should be provisioned. BellSouth's positions regarding network element combinations, however, do not justify ignoring forward-looking IDLC technology in network element cost studies (whose inflated results are thus incorrect).

"RESIDUAL HISTORICAL COSTS"

Q. DOES BELLSOUTH ENDORSE ESTABLISHING COST-BASED PRICES FOR NETWORK ELEMENTS?

A. No. Mr. Varner's direct testimony (page 18) recommends that network element prices should also include a so called "residual recovery requirement" in the rates for some network elements. Mr. Varner claims that without this non-cost surcharge "[i]n the long run, the Florida consumer, and more likely, the rural consumer, will be required to make up the difference". (Varner direct, page 21).

Q. SHOULD BELLSOUTH BE PERMITTED TO IMPOSE THESE UNEXPLAINED RESIDUAL COSTS ON COMPETITORS?

A. No. As a threshold matter, Mr. Varner's testimony never provides an explanation of what these costs are, or how they could conceivably be related to the provision of network elements. I expect that other witnesses will address these points, however, including the fundamental incompatibility of "residual costing" with economic pricing and the Commission's prior findings on this issue.

The point to which I direct my rebuttal is the remarkable assertion that *consumers* will be better off -- particularly those few rural consumers served by *BellSouth* -- if BellSouth is permitted to inflate its competitor's costs. Allowing BellSouth to impose uneconomic costs on competitors will simply assure that these remain embedded in retail rates, with no hope that competition will force prices down to more efficient levels.

Q. WHAT IS THE BEST PATH TO PROTECT CONSUMERS FROM BELLSOUTH CHARGING HIGHER PRICES?

A. The only real protection from BellSouth charging consumers higher prices in the future is if consumers enjoy a choice in local provider. BellSouth is an investor-owned corporation with the goal of maximizing its profits. Like any commercial firm, if it *can* charge higher prices, it *will*.

One goal of the federal telecommunications Act is to rely on competition to limit the incumbent's ability to raise its prices. Of course, this strategy requires that consumers have a choice in local provider, which first requires that entrants have

the ability to enter and compete with BellSouth in a meaningful way.

Q. HOW WILL CARRIERS BE ABLE TO ENTER AND OFFER COMPETE WITH BELLSOUTH?

A. The only known method to enter the market broadly and provide price and product competition to BellSouth is through the use of network elements. Service-resale (i.e., the resale of BellSouth's retail services at a wholesale discount) binds the entrant to the service-design and pricing-decisions of the incumbent. Resale cannot constrain BellSouth from raising its prices because the entrant's costs increase in lock-step with any increase in BellSouth's retail rates.

The entry mechanism that will bring price and product competition is the use of network elements. Of course, this promise will remain unrealized until network elements can be provisioned on a commercial scale and easily used by entrants to offer service to average customers -- but this is an issue for the Commission's upcoming proceeding addressing network element combinations.

Q. WHAT WOULD BE THE EFFECT ON CONSUMER PRICES OF BELLSOUTH'S PROPOSAL TO INFLATE NETWORK ELEMENT RATES?

A. In effect, BellSouth is asking the Commission to *hamper* its competitor's ability to limit BellSouth's prices. If BellSouth is able to increase the price of network elements, then its competitors will be limited in their ability to offer lower prices alternatives to consumers. By increasing its competitor's *costs,* BellSouth would be able to increase retail *prices* without fear of losing customers.

If network element prices *are not* inflated by uneconomic costs, however, then BellSouth's competitors would be better positioned to act as a competitive limit on BellSouth's prices. The best protection that the Commission can provide Florida consumers in the future is assuring that they enjoy competitive choice as soon as possible. This result is best accomplished through network element prices which are based on the forward-looking costs of an efficient network-element provider.

INTEGRATED DIGITAL LOOP TECHNOLOGY

Q. PLEASE PROVIDE A SIMPLE DESCRIPTION OF INTEGRATED DIGITAL LOOP (IDLC) TECHNOLOGY.

A. IDLC technology is a more efficient way to perform the loop function by multiplexing individual customer connections (i.e., loops) onto a high-capacity facility for transport to the central office switch. At the central office, the high-capacity transmission facility terminates directly within the switch (that is, it is "integrated" into the switch) where individual "loops" are provided dial-tone. This integration avoids unnecessary de-multiplexing to derive loop channels which would otherwise require individual cross-connection with a switch-port.

Q. HAS BELLSOUTH PREVIOUSLY ACKNOWLEDGED IDLC AS A FORWARD-LOOKING TECHNOLOGY?

A. Yes. BellSouth witnesses have testified in a number of universal service proceedings that IDLC technology is the foward-looking choice in a number of applications. There does not appear to be any serious disagreement on this point.

Q. IS THERE BASIC AGREEMENT THAT NETWORK ELEMENT COST STUDIES SHOULD REFLECT FORWARD LOOKING TECHNOLOGY?

A. Yes. BellSouth agrees that network element cost studies should be forward-looking. For instance, Mr. Baeza's direct testimony (page 3) clearly states:

> As in the case with any good cost study, the network design of a TSLRIC study should (1) include forward-looking incremental costs, and (2) be based on the incumbent LEC's existing wire center locations and the most efficient technology available.

Consequently, there is no dispute that (1) network element costs studies *should* estimate forward-looking costs and (2) IDLC technology *is* the forward-looking technology.

Q. DO BELLSOUTH'S LOOP COST STUDIES MODEL THE COSTS OF IDLC TECHNOLOGY?

A. No. Despite the consensus that network element cost studies should reflect forward-looking costs -- and agreement that IDLC technology is an appropriate forward-looking technology -- BellSouth's cost studies ignore this option. The entire explanation for this position is a single sentence in Mr. Baeza's direct testimony (page 5):

Integrated DLC is not used in the cost study since BellSouth must be able to provision a loop on a stand-alone basis.

Q. IS MR. BAEZA'S "EXPLANATION" REASONABLE?

A. No. Because Mr. Baeza's testimony provides no elaboration beyond the above sentence, I must assume that it is based on BellSouth's interpretation of the Eighth Circuit's decision on network element combinations. Although the Commission has deferred a number of issues concerning network element combinations to a separate proceeding with a primary focus on *non-recurring* costs, it is important to understand that BellSouth's positions inflate it *recurring* costs as well.

Q. PLEASE EXPLAIN YOUR UNDERSTANDING OF THE RELATIONSHIP BETWEEN THE EIGHTH CIRCUIT'S REHEARING DECISION AND BELLSOUTH'S DECISION TO IGNORE IDLC TECHNOLOGY.

A. BellSouth has indicated in other forums that it interprets the Eighth Circuit's decision to require the physical separation (and delivery to a collocation arrangement) of loops on a stand-alone basis. BellSouth apparently believes that this interpretation can be used to deny access to IDLC arrangements where the loop is integrated with the switch. In my opinion, BellSouth's position -- particularly with respect to IDLC arrangements -- is incorrect.

As I explain below, the Eighth Circuit's decision does not *require* -- in fact, to the contrary, it does not even *permit* -- the type of loop/port provisioning assumed by BellSouth. Second, *even if* the Eighth Circuit decision did require the physical

separation of *copper* loops as claimed by BellSouth, BellSouth would still be obligated to provide entrants access to IDLC technology where separation is not technically possible. Under either scenario, BellSouth's cost studies should reflect IDLC-costs where it is the most efficient forward-looking technology.

Q. PLEASE SUMMARIZE WHAT YOU UNDERSTAND TO BE THE IMPACT OF THE EIGHTH CIRCUIT'S REHEARING DECISION ON NETWORK ELEMENT COMBINATIONS.

A. To begin, it is important to understand that the Eighth Circuit unambiguously rejected BellSouth's long standing position that network element combinations were service-resale:

> Initially, we [the Court] believe that the plain language of subsection 251(c)(3) indicates that a requesting carrier may achieve the capability to provide telecommunications services completely through access to the unbundled elements of an incumbent LEC's network.
>
> ***
>
> We conclude that the Commission's belief that competing carriers may obtain the ability to provide finished telecommunications services entirely through the unbundled access provisions in subsection 251(c)(3) is consistent with the plain

meaning and structure of the Act.

The above conclusion is important because it serves to emphasize that the issue is not *whether* entrants are entitled to provide service using loop/port combinations obtained from BellSouth at cost-based rates, but rather *how* the entrant may access and combine these facilities.

Q. DOES THE EIGHTH CIRCUIT'S ORDER DEMAND THAT BELLSOUTH PROVISION LOOPS ONLY ON A STAND-ALONE BASIS?

A. No. My understanding of the Court's decisions are that BellSouth must provide network elements to be used in combinations in a manner which essentially satisfies a two-prong test:

(1) the entrant must have non-discriminatory access to combine the facilities themselves, and

(2) the entrant cannot be required to own or control some portion of a telecommunications network before being able to purchase unbundled elements.

BellSouth's proposal requiring an entrant to first acquire collocation space and install cross-connection equipment violates at least the second prong of the Court's order (and, although it requires more discussion than is necessary here, the first prong as well).

Q. DO YOU BELIEVE THERE ARE ACCESS ARRANGEMENTS THAT WOULD SATISFY BOTH PRONGS OF THE COURT'S ORDER?

A. Yes. Recombining elements by manually disconnecting and reconnecting wires is not the only method of separating and recombining the loop and switching elements. One alternative method would be an electronic separation and recombination using BellSouth's "recent change" process. ("Recent change" is the process that BellSouth uses today to separate, recombine, and modify elements such as the loop, switching, and transport, to serve their customers.)

Under this approach, the loop and port separation would occur by BellSouth sending a message -- known as a "recent change" -- that instructs the switch software to block the connection between a specified switch port and its associated loop. To recombine these facilities, the entrant would send a comparable electronic message to the switch instructing it to restore the connection.

This electronic process would disconnect the loop from the switch every bit as effectively as if BellSouth had assigned a technician in the central office instructions to disconnect manually a specific loop and port arrangement. The difference, however, is that this "electronic" process would satisfy the Court's requirement that the entrant be able to recombine facilities in a non-discriminatory manner without the need for its own facilities.

Q. WHAT IS THE RELEVANCE OF THIS METHOD TO MR. BAEZA'S COST TESTIMONY?

A. Mr. Baeza's testimony ignores the lower costs of IDLC technology with the explanation that IDLC technology cannot be used as part of a network-element arrangement. The above discussion shows, however, that IDLC technology *can be* used in loop/port arrangements that are combined consistent with the Eighth Circuit's order. As a result, Mr. Baeza's justification for ignoring this lower cost technology is incorrect and the lower costs of IDLC technology should not have been excluded from his study.

Q. ARE THERE OTHER REASONS TO REJECT MR. BAEZA'S CONTENTION THAT IDLC TECHNOLOGY IS IRRELEVANT TO THE COSTING OF NETWORK ELEMENTS?

A. Yes. The mere fact that an IDLC arrangement cannot be separated into distinct loop and port components *does not* relieve BellSouth's obligation to provide entrants access to these facilities. The term "network element" is quite broad:

> The term "network element" means a facility or equipment used in the provision of a telecommunications service. Such term also includes features, functions, and capabilities that are provided by means of such facility or equipment ...

Nothing in the Act suggests that if a facility cannot be divided into smaller functional components, that the incumbent LEC's obligation to provide access then disappears. In fact, the Eighth Circuit's decision stated the opposite conclusion (underlining in the original):

> ... subsection 251(c)(3) places a duty on incumbent LECs to provide "access to network elements on an unbundled basis at any technically feasible point." By its very terms, this provision only indicates where unbundled access may occur, not which elements must be unbundled.

In other words, so long as it is the *access* to the network element can be unbundled, the *physical element* itself need not be. The fact that IDLC technology cannot be separated into distinct loop and port components only means that BellSouth must offer access to the entire functionality.

Because BellSouth cannot avoid its obligation to provide access to IDLC technology as a network element, its cost-studies must include IDLC where is the least cost technology choice. BellSouth's filed studies which ignore IDLC technology are inflated and violate the Act, TSLRIC principles and this Commission's arbitration decision.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.