

**ORIGINAL**

**BEFORE THE**

**FLORIDA PUBLIC SERVICE COMMISSION**

**REBUTTAL TESTIMONY OF**

**JOSEPH GILLAN**

**ON BEHALF OF**

**AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.**

**AND**

**MCI TELECOMMUNICATIONS CORPORATION**

**DOCKET NO.: 971140-TP**

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5 AND  
6 MCI TELECOMMUNICATIONS CORPORATION  
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8  
9 **INTRODUCTION**

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**Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

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

**Q. ON WHOSE BEHALF ARE YOU FILING REBUTTAL TESTIMONY?**

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

**Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

A. The purpose of my rebuttal testimony is to respond to the testimony of BellSouth witnesses Varner and Hendrix concerning the pricing and provisioning of network element combinations. At one level, there appears to be agreement on the basic questions needed to address the issues in this proceeding:

1 \* BellSouth admits that it must offer network element combinations without  
2 disruption (Varner, page 4: "Currently, language in the interconnection  
3 agreements obligates BellSouth to provide combined UNEs.").

4  
5 \* BellSouth agrees that its interconnection agreements apply until the  
6 Supreme Court rules on the Eighth Circuit's decision (Varner, page  
7 4: "... with respect to the interconnection agreements BellSouth  
8 signed with MCI and AT&T, language requiring BellSouth to  
9 combine UNEs will remain in those agreements only until such time  
10 as the Supreme Court has completed its review...").

11  
12 \* BellSouth acknowledges that network element prices are required by  
13 statute to be cost-based, not a wholesale discount off a retail price  
14 (Varner, page 14: "In Section 252(d) of the Act, Congress  
15 established two pricing standards, one for interconnection and UNEs  
16 and one for the resale of existing services.").

17  
18 The straight-forward application of simple logic to these uncontested facts *should*  
19 answer the listed issues in this proceeding: network element combinations must be  
20 priced at cost-based rates, including cost-based non-recurring charges for the non-  
21 discriminatory migration of network element combinations to other entrants.  
22 BellSouth's testimony, however, seeks to avoid this logical result, requesting instead  
23 that the Commission apply a "third" pricing standard that would apply the wholesale  
24 discount whenever an entrant uses network elements to "recreate" a BellSouth  
25 service.

1 **Q. WHICH SPECIFIC AREAS OF BELLSOUTH'S TESTIMONY DOES**  
2 **YOUR REBUTTAL TESTIMONY ADDRESS?**

3 A. In the rebuttal testimony which follows, I make the following points:

4

5 \* The Eight Circuit decision fundamental affirmed the entrant's right  
6 to compete using network element combinations, paying cost-based  
7 rates. The Eighth Circuit considered and rejected BellSouth's  
8 argument that network element combinations are equivalent to  
9 service-resale -- a claim which lies at the heart of its testimony in  
10 this docket.

11

12 \* Although the Eighth Circuit concluded that BellSouth is not  
13 obligated by the federal Act to combine network elements, its  
14 decision also emphasized that BellSouth must provide entrants non-  
15 discriminatory access to combine the elements themselves.  
16 Consequently, even if the Eighth Circuit decision is upheld by the  
17 Supreme Court, BellSouth must still accommodate network element-  
18 based competition.

19

20 \* There are critical and important differences between network  
21 element combinations and service-resale in terms of potential  
22 innovation, risk and competitive opportunity. The fact is that  
23 network element-based competition has the potential to bring  
24 substantial benefits to Florida consumers -- benefits that are not  
25 possible with service-resale. By insisting that network element

1 combinations *are* service-resale, BellSouth seeks to effect a self-  
2 fulfilling prophesy that would deny consumers the potential benefits  
3 of this important competitive form.

4  
5 \* An important characteristic of network element-based competition is  
6 that entrants lease the *complete* functionality of the loop and switch  
7 elements, replacing BellSouth as the provider of *both* local exchange  
8 and exchange access services with respect to their own customers.  
9 BellSouth, however, is requesting that it retain a monopoly on  
10 intrastate access -- a position completely at odds with the  
11 fundamental notion of network elements and network element-based  
12 competition.

13  
14 **THE EIGHTH CIRCUIT DECISION**

15  
16 **Q. PLEASE SUMMARIZE THE EIGHTH CIRCUIT'S DECISION AS IT**  
17 **RELATES TO NETWORK ELEMENT COMBINATIONS.**

18 A. To begin, it is important to understand that the Eighth Circuit fundamentally  
19 affirmed the entrant's right to provide service using network element combinations  
20 obtained from BellSouth at cost-based rates:

21  
22 The petitioners [such as BellSouth] assert that a competing  
23 carrier should own or control some of its own local exchange  
24 facilities before it can purchase and use unbundled elements  
25 from an incumbent LEC to provide a telecommunications

1 service. The petitioners argue that subsection 251(c)(4)  
2 makes resale the exclusive means to offer finished  
3 telecommunications services for competing carriers that do  
4 not own or control any portion of a telecommunications  
5 network. Furthermore, the petitioners point out that under  
6 subsection 251(c)(4) a competing carrier may purchase the  
7 right to resell a telecommunications service from an  
8 incumbent LEC only at wholesale rates.

9  
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11  
12 Initially, we [the Court] believe that the plain language of  
13 subsection 251(c)(3) indicates that a requesting carrier may  
14 achieve the capability to provide telecommunications  
15 services completely through access to the unbundled  
16 elements of an incumbent LEC's network. Nothing in this  
17 subsection requires a competing carrier to own or control  
18 some portion of a telecommunications network before being  
19 able to purchase unbundled elements.

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22  
23 We conclude that the [Federal Communications]  
24 Commission's belief that competing carriers may obtain the  
25 ability to provide finished telecommunications services

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entirely through the unbundled access provisions in subsection 251(c)(3) is consistent with the plain meaning and structure of the Act.

**Q. IF THE COURT FUNDAMENTALLY AFFIRMED THE ENTRANT'S RIGHT TO USE NETWORK ELEMENT COMBINATIONS TO OFFER SERVICE, WHY IS THERE SUCH CONTROVERSY CONCERNING ITS OPINION?**

A. Although the Court sustained the entrant's right to use network element combinations to provide services, the Court also decided that the entrant should combine the elements themselves. BellSouth has interpreted this provision to permit it to sabotage its network, ripping elements apart so that it can increase its competitor's costs, and forcing these entrants to install collocated facilities to restore the elements to their original configuration.

Fortunately, however, BellSouth acknowledges that the MCI/AT&T interconnection agreements prohibit this disruptive practice and BellSouth agrees that it must "provide" access to network elements that are currently combined until the Supreme Court issues a final decision on the Eighth Circuit's opinion. (I explain in the following section of my rebuttal that BellSouth's view of "providing" network element combinations does not include actually acknowledging combinations as network elements in any material respect, thereby rendering this agreement meaningless).

1 Q. ASSUMING THE SUPREME COURT UPHOLDS THE EIGHTH CIRCUIT,  
2 WHAT WOULD BE THE EFFECT ON BELL SOUTH'S OBLIGATIONS  
3 TO SUPPORT NETWORK ELEMENT COMBINATIONS?

4 A. The Eighth Circuit's decision (even if it is upheld on appeal) does not *absolve*  
5 BellSouth from an obligation to support network element combinations, it only  
6 changes the *form* of that obligation. Today, BellSouth is prohibited from disrupting  
7 network combinations under the terms of the AT&T/MCI interconnection  
8 agreements. But, even if those contracts must ultimately be modified to conform to  
9 the Eighth Circuit's decision, BellSouth must implement a separation/recombination  
10 process that complies with a full reading of the Court's Order.

11  
12 Two provisions of the Eighth Circuit's decision are particularly relevant to this  
13 issue:

14  
15 ... the fact that the incumbent LECs object to this rule  
16 [requiring that the LEC combine elements] indicates to us  
17 that they would rather allow entrants access to their networks  
18 than have to rebundle the unbundled elements for them.

19  
20 ... 251(c)(3) indicates that a requesting carrier may achieve  
21 the capability to provide telecommunications services  
22 completely through access to the unbundled elements of an  
23 incumbent LEC's network. Nothing in this subsection  
24 requires a competing carrier to own or control some portion  
25 of a telecommunications network before being able to



1 purchase unbundled elements.

2

3 **Q. WHAT IS THE PRACTICAL SIGNIFICANCE OF THESE PROVISIONS?**

4 A. What these provisions mean is that even if the Eighth Circuit's decision is upheld,  
5 BellSouth must still support network element combinations in a manner which  
6 satisfies a two-prong test:

7

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

10 (2) the entrant cannot be required to own or control facilities before it is  
11 able to use network elements.

12

13 BellSouth's demand that entrants install collocated facilities in order to use network  
14 element combinations violates both prongs of this test. Mr. Falcone's rebuttal  
15 testimony addresses in more detail the deficiencies of BellSouth's collocated-  
16 facilities proposal. The point of my rebuttal here, however, is to emphasize that  
17 under *either* legal scenario -- the Eighth Circuit is reversed or upheld -- BellSouth  
18 must still support network element combinations. The only question is *how?*

19

20 **Q. WHAT WOULD BE THE MOST EFFICIENT METHOD TO**  
21 **SEPARATE/RECOMBINE NETWORK ELEMENTS, ASSUMING THAT**  
22 **THE EIGHTH CIRCUIT DECISION STANDS?**

23 A. The most efficient method currently available to separate and recombine loop and  
24 switching elements would be an electronic separation and recombination using  
25 BellSouth's "recent change" process. ("Recent change" is the process that BellSouth

1 uses today to separate, recombine, and modify elements such as the loop, switching,  
2 and transport, to serve their customers.)

3  
4 Under this approach, the loop and switch separation would occur by BellSouth  
5 sending a message -- known as a "recent change" -- that instructs the switch  
6 software to block the connection between a specified switch port and its associated  
7 loop. To recombine these facilities, the entrant would send a comparable electronic  
8 message to the switch instructing it to restore the connection.

9  
10 This electronic process would disconnect the loop from the switch every bit as  
11 effectively as if BellSouth had assigned a technician in the central office to  
12 disconnect manually a specific loop and switch-port arrangement. The difference,  
13 however, is that this "electronic" process would satisfy the Court's requirement that  
14 the entrant be able to recombine facilities in a non-discriminatory manner without  
15 the need for its own facilities. Mr. Falcone's testimony describes this alternative in  
16 detail.

17  
18 **Q. HOW DOES THIS APPROACH RELATE TO THE NON-RECURRING**  
19 **CHARGE ISSUE ADDRESSED IN THIS PROCEEDING?**

20 A. AT&T and MCI have sponsored witnesses in this proceeding which describe the  
21 appropriate non-recurring charge when network element combinations are  
22 provisioned efficiently (which is to say electronically) to an entrant. Included  
23 within this estimated cost is the cost of a "recent-change" similar to that described  
24 above. These studies are also useful to understand the potential impact if the Eighth  
25 Circuit's decision is upheld -- in simple terms, the provisioning process could then

1 be described as involving *two* recent-change instructions to achieve the same result,  
2 and a cost-based non-recurring charge could be *no greater* than twice the level  
3 recommended by these witnesses.

4  
5 This back-of-the-envelop calculation suggests that the *maximum* effect of an adverse  
6 (to competition) Supreme Court decision would be an increased non-recurring  
7 charge of roughly \$1.67 (Hyde, page 11). I want to emphasize that I am not  
8 recommending a charge of this magnitude -- a charge at this level would still be too  
9 large and, in any event, the NRC that would apply at the conclusion of this contract  
10 is not an issue in this proceeding -- but I did want to show that the effect of the  
11 Eighth Circuit's decision (even if upheld) is not as dramatic as BellSouth claims.

12  
13 **Q. SHOULD THE COMMISSION BE PARTICULARLY CONCERNED WITH**  
14 **INFLATED NON-RECURRING CHARGES?**

15 A. Yes, it is particularly important that the Commission carefully guard against inflated  
16 non-recurring charges. The fundamental intent of the Act is to *eliminate* barriers to  
17 entry in the local market. The basic effect of a non-recurring charge, however, is to  
18 *create* a barrier to entry. Because NRCs are imposed whenever change occurs, they  
19 fundamentally protect the status quo. The starting point for a competitive local  
20 environment, however, is decidedly one-sided. Today, *all* the local customers are  
21 served by the incumbent. Therefore, any charge that is tied to a customer's decision  
22 to change carriers constitutes a barrier to the exercise of that choice and provides the  
23 incumbent a shield from competitive pressures.

24  
25 The central pricing issue of this proceeding is the non-recurring charge appropriate

1 to the facilities-migration of network elements to an entrant. This event must  
2 become an efficient, routine and inexpensive process if the benefits of local  
3 competition are ever to extend broadly to Florida consumers. The Commission  
4 should establish a cost-based non-recurring charge which reflects the  
5 implementation of the automated systems necessary to support this competition.  
6

7 **BELLSOUTH'S REQUEST FOR A "THIRD" PRICING STANDARD**  
8

9 **Q. DOES BELLSOUTH ACKNOWLEDGE ITS OBLIGATION TO OFFER**  
10 **NETWORK ELEMENT COMBINATIONS AT COST-BASED RATES?**

11 A. No. BellSouth's position in this proceeding is that a third pricing standard should  
12 apply whenever network elements are used to "recreate" a BellSouth service  
13 (Varner, page 9). According to BellSouth, under this circumstance, network  
14 elements cease existing as network elements and are priced using a wholesale  
15 discount.  
16

17 **Q. IS THERE ANY PART OF THE EIGHTH CIRCUIT'S DECISION, OR THE**  
18 **ACT, THAT SUPPORTS THE APPLICATION OF A THIRD PRICING**  
19 **STANDARD?**

20 A. No. BellSouth's third standard is contrived from whole cloth. On the one hand,  
21 BellSouth acknowledges that it must *provide* network elements in undisturbed  
22 combination (as required by its contracts), yet it simultaneously concludes that it  
23 need not *respect* them as network elements in any material way (Mr. Hendrix , page  
24 3):  
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BellSouth has consistently taken the position that ALECs are free to use unbundled network elements recombined by BellSouth in any manner it chooses. However, in Florida, when an ALEC orders a combination of network elements or orders individual network elements that, when combined, duplicate a retail service provided by BellSouth, for purposes of billing and provisioning, such orders should be treated as resale.

In other words, entrants are *entitled* to network element combinations, so long as they are not treated *as* network elements. With this single statement, BellSouth renders meaningless the entire premise of non-discriminatory access: entrants are entitled to use network elements in the same way as BellSouth -- but if they do, BellSouth will no longer consider them network elements in how they are priced or provisioned. There is simply nothing in the Act (or the Eighth Circuit's decision) which suggests that the definition, pricing and provisioning of a network element depends upon the entrant's use or the services that it offers.

**Q. HOW DOES BELLSOUTH DEFINE "RECREATING" A BELLSOUTH SERVICE USING NETWORK ELEMENTS?**

A. BellSouth's definition of "re-create" is the swamp at the end of this road (Hendrix, page 10):

1           The real test for this Commission will be to look at the core  
2           functions of the requested combination to see if those  
3           functions mirror the functions of an existing retail service  
4           offering.

5  
6  
7   **Q.    IS THIS A MEANINGFUL STANDARD?**

8    A.    No. Assuming for the moment that it is even reasonable to discuss this issue -- it is  
9           not -- network elements will *always* be used to recreate a BellSouth service under  
10          this definition. Telecommunications services, including local services, are provided  
11          with a very predicable and standardized set of generic ingredients. These generic  
12          ingredients are called network elements. The *reason* an entrant purchases the loop  
13          and switch network elements is to obtain the "core functions" necessary to provide  
14          local exchange and exchange access services. There is no other reason to purchase  
15          them.

16  
17   **Q.    SHOULD THE COMMISSION EXPECT ENTRANTS WILL USE**  
18          **NETWORK ELEMENT COMBINATIONS TO OFFER SERVICES**  
19          **SIMILAR TO BELLSOUTH?**

20   A.    Yes. The Commission should expect that entrants will offer services similar to  
21          BellSouth, whether they use network elements or their own facilities. Among other  
22          reasons, the more similar the service, the easier it will be for consumers to compare  
23          prices. Price competition is one of the hoped-for benefits of the Act and the  
24          potential for meaningful price competition is one of the key reasons that Congress  
25          mandated that BellSouth allow others to provide service entirely over the BellSouth

1 network at cost-based rates.

2

3 **Q. DOES BELLSOUTH RECOMMEND SPECIFIC LANGUAGE TO THE**  
4 **COMMISSION TO IMPLEMENT ITS "RECREATION-BASED" PRICING**  
5 **STANDARD?**

6

7 A. Yes. Notably, however, the language that BellSouth recommends (Hendrix, page  
8 10) directly conflicts with the Eighth Circuit's decision. BellSouth recommends that  
9 the Commission adopt a provision similar to that adopted by the Georgia  
10 Commission (Docket No. 6801-U) prior to the Eighth Circuit order:

11

12 ... "identical" means that AT&T is not using its own  
13 switching or other functionality or capability together with  
14 unbundled elements in order to provide service"

15

16 Contrast this provision to the clear statement of the Eighth Circuit:

17

18 ... the plain language of subsection 251(c)(3) indicates that a  
19 requesting carrier may achieve the capability to provide  
20 telecommunications services completely through access to  
21 the unbundled elements of an incumbent LEC's network.  
22 Nothing in this subsection requires a competing carrier to  
23 own or control some portion of a telecommunications  
24 network before being able to purchase unbundled elements.

25

1 No matter how much BellSouth protests, entrants have the right to provide service  
2 entirely using network elements obtained from BellSouth. Further, network element  
3 prices are based on cost, whether used alone or in combination. No matter how  
4 much BellSouth would like to *redefine* network element combinations as service-  
5 resale, these are distinct entry options that must be respected as such.

6  
7 **UNE COMBINATIONS ARE NOT SERVICE RESALE**

8  
9 **Q. PLEASE DESCRIBE THE MOST COMMON COMBINATION THAT**  
10 **ENTRANTS WILL USE TO COMPETE IN THE LOCAL MARKET.**

11 A. The Commission should expect that entrants will use network elements in the  
12 combinations they are designed for -- that is, combining a loop with switch capacity,  
13 interconnected with the signaling and transport facilities necessary to complete calls.  
14 There is little room in this industry for network-improvisation and it should be no  
15 surprise that entrants will use network elements in the same combinations as  
16 BellSouth -- this is, after all, how the network is designed to work.

17  
18 **Q. IF THE NETWORK FACILITIES REMAIN IN THE SAME**  
19 **CONFIGURATION (AT LEAST INITIALLY), THEN WHAT IS THE**  
20 **DIFFERENCE BETWEEN A UNE-COMBINATION AND SERVICE-**  
21 **RESALE.**

22 A. There are a number of important differences between the lease of network *facilities* -  
23 - particularly facilities which provide multiple services, including local exchange  
24 services, intraLATA toll services, vertical features and access services -- and the  
25 resale of a single *service* as defined by the incumbent LEC.



1 Network elements are an entry strategy that enables the entrant to fully step into the  
2 role of a local telephone company, with the same economic constraints and  
3 freedoms as any other local carrier. The entrant purchases a set of facilities (or, more  
4 precisely, access to facilities), compensates the incumbent for the indivisible cost of  
5 those facilities (such as the fixed cost of the local loop), and then bears the economic  
6 responsibility to price the full range of services which use those facilities (local  
7 exchange, intraLATA toll, and exchange access to name a few) to recover its costs  
8 and make a profit.

9  
10 Service-resale, in contrast, establishes the entrant as the incumbent's marketing  
11 agent. The incumbent determines what services will be offered and what prices will  
12 be charged in its retail tariff; the entrant's role is to market and bill for these services  
13 under (presumably) its own label. Service resale is fundamentally different in  
14 virtually every respect from network element combinations: it has a different  
15 risk/reward profile, it requires a different level of technological proficiency, and it  
16 provides a different opportunity to innovate.

17  
18 **Q. HOW DO THE RISK/REWARD PROFILES COMPARE?**

19 A. There is much less risk in a service-resale environment. With service-resale, the  
20 entrant essentially reoffers, under its own label, a retail product designed, priced and  
21 even administratively organized according to the incumbent's USOC codes. The  
22 cost-structure of the entrant *exactly parallels* the prices of the incumbent and, for all  
23 practical purposes, its own revenues as well. Because the entrant's costs and  
24 revenues move in lock-step, there is very little risk -- the potential margin is defined  
25 by the wholesale discount and it remains fixed as customers purchase more, or less,

1 service.

2

3 **Q. WHAT FACTORS AFFECT THE RISK ASSOCIATED WITH THE USE**  
4 **OF NETWORK ELEMENTS?**

5 A. A network element-based competitor leases the underlying facilities necessary to  
6 become a local provider, paying a cost-based rate to obtain the complete  
7 functionality of the key facilities involved (the loop and switch capacity). There are  
8 two consequences of this relationship.

9

10 First, the network element-based competitor becomes the provider of both the retail  
11 service to its customers and the exchange-access/interconnection service to other  
12 carriers. This form of competition places the entrant squarely in the shoes of the  
13 incumbent, compensating the incumbent for the cost of the facilities, yet enabling  
14 the entrant to offer same range of services from which to generate offsetting  
15 revenues.

16

17 Second, unlike service-resale, there is no predefined relationship between the  
18 entrant's cost structure and its potential revenues. Much of the entrant's cost (for  
19 example, the loop and switch port) is incurred as a flat-rate per month -- even  
20 though many of its potential *revenues* (from access, ECS and toll usage, for  
21 instance) are a function of usage. Conversely, some network elements impose a  
22 usage-cost (such as common transport to terminate local calls), even though the  
23 corresponding revenues are fixed (as part of the local bill).

24

25 The result is that the network element option presents a far different risk/reward

1 profile than service-resale -- a fact recognized by the Eighth Circuit when it rejected  
2 BellSouth's view that these entry mechanisms were the same:

3

4 Carriers entering the local telecommunications markets by  
5 purchasing unbundled network elements face greater risks  
6 than those carriers that resell an incumbent LEC's services.

7

8 A carrier purchasing network elements (like the incumbent itself) incurs the  
9 substantial fixed cost of local service, with the hope that additional services/features  
10 will provide additional revenues. This uncertainty creates the risk -- and its  
11 complement, opportunity -- that does not exist under the service-resale.

12

13 **Q. MR. VARNER'S TESTIMONY (PAGES 10-12) ATTEMPTS TO**  
14 **CHARACTERIZE THE NETWORK-ELEMENT OPTION AS PROVIDING**  
15 **RESALE AT A GREATER DISCOUNT. IS THIS VALID?**

16 A. No. The network element option is a distinct business opportunity, with a different  
17 level of potential revenues, costs and risks than service resale. Certainly, it is  
18 mathematically possible to compare the financial performance of each option as a  
19 "discount" -- I have even seen AT&T use this approach as analytical short-hand  
20 with stock analysts. But, the fact that network elements can be *compared* to a  
21 wholesale discount does not mean that they are *equivalent* to receiving a discount.

22

23 **Q. CAN YOU PROVIDE AN EXAMPLE OF THE POTENTIAL BENEFIT**  
24 **FROM NETWORK ELEMENT-BASED COMPETITION?**

25

1 A. Yes. Attached to Mr. Varner's testimony is an exhibit which compares the relative  
2 costs/revenues for the typical residential customer under service-resale and the  
3 network elements (Exhibit AJV-1, Chart C). Accepting for the moment that this  
4 analysis is correct (more on that below), Mr. Varner estimates that an entrant's  
5 "cost" to serve the typical residential customer is \$30.69 using service-resale and  
6 \$28.47 using network elements. Mr. Varner characterizes this difference (\$2.22) as  
7 a "windfall" to MCI and AT&T (Varner, page 16).

8

9 **Q. IS IT REASONABLE TO CHARACTERIZE THIS \$2.22 AS A WINDFALL**  
10 **TO AT&T AND MCI?**

11 A. No. Mr. Varner's characterization is colored from his perspective as a monopolist.  
12 Because BellSouth is a monopolist, this additional \$2.22 does provide a windfall to  
13 BellSouth, but only because BellSouth has no competitor seeking to win this  
14 customer by offering lower prices. In the absence of competition, BellSouth can  
15 charge residential customers the prices which create this windfall and, unless  
16 network element-based competition can become a reality, this \$2.22 windfall will  
17 continue for many years to come.

18

19 The benefit of network element-based entry, however, is that the \$2.22 is  
20 transformed from BellSouth-windfall to potential ratepayer-benefit. Neither AT&T,  
21 nor MCI (nor BellSouth) will be able to retain the \$2.22 margin because each  
22 company will be engaged in a battle to win the customer from the others. Mr.  
23 Varner's exhibit illustrates *why* network element-based competition is so important -  
24 - it enables market forces to drive the gap between retail revenues and network cost  
25 to its lowest possible level.

1 Q. DOES THIS POTENTIAL BENEFIT DEPEND UPON THE COMMISSION  
2 CORRECTLY ESTABLISHING A COST-BASED NON-RECURRING  
3 CHARGE IN THIS PROCEEDING?

4 A. Yes. Competitors can only offer lower prices to those customers which they can  
5 efficiently serve. The non-recurring charge proposed by BellSouth (\$169.10 per  
6 network element combination) would effectively prevent competition from bringing  
7 lower prices to average consumers. A non-recurring charge at this level would  
8 assure that the Mr. Varner's \$2.22 residential windfall -- a windfall which translates  
9 to more than \$94 million in revenue annually -- would remain embedded in  
10 residential rates for the foreseeable future.

11  
12 Q. YOU INDICATED EARLIER THAT MR. VARNER'S ANALYSIS IS  
13 INACCURATE. IN WHAT WAY IS IT INACCURATE?

14 A. Mr. Varner's comparison incorrectly considers the revenues and costs associated  
15 with access service. First, his analysis is premised on BellSouth maintaining an  
16 *intrastate* access monopoly, thereby denying an additional \$3.56 of potential benefit  
17 from residential customers. I explain why BellSouth's position on intrastate access  
18 is flawed in the final section of this testimony. Second, Mr. Varner did not appear  
19 to include the additional network-element cost incurred by the entrant to provide  
20 *interstate* access service.

21  
22 Q. HAVE YOU REVISED MR. VARNER'S ANALYSIS TO CORRECTLY  
23 INCORPORATE ACCESS?

24 A. Yes. Exhibit JPG-1 (attached) compares the service-resale and network-element  
25 options to more clearly illustrate the fundamental differences between these entry

1 options and to correctly include the network-element costs incurred by the entrant to  
2 provide access services. This corrected analysis estimates that the potential benefit  
3 of network element-based competition to the average residential consumer is  
4 approximately \$4.36 per month, nearly double Mr. Varner's estimate of \$2.22. (To  
5 be precise, the \$4.36 in potential benefit should be reduced by the additional costs  
6 incurred by a network element-based entrant to offer switched access and  
7 interconnection services, as well as the internal costs to manage a network element-  
8 based business).

9  
10 **Q. WHAT ARE OTHER DIFFERENCES BETWEEN SERVICE-RESALE AND**  
11 **NETWORK ELEMENT-BASED COMPETITION?**

12 A. As noted, one of the key differences is that the network element-based entrant offers  
13 both local exchange and exchange access services. This characteristic is important  
14 because it provides the entrant with the same economic stature as the incumbent,  
15 bringing competitive pressure to both retail local exchange and (through the prism  
16 of the exchange access market) long distance prices as well.

17  
18 **Q. ARE NETWORK ELEMENTS SUBJECT TO SERVICE-DEFINING**  
19 **RESTRICTIONS OF THE INCUMBENT LEC'S DESIGN?**

20 A. No. Network elements are offered as basic generic functionalities, free of  
21 restriction. Services can be designed for new customer classes, basic services can  
22 include features and functions that BellSouth only makes available as expensive  
23 options, or network elements can be used by the entrant to craft its own promotions  
24 and special packages.

25

1 In addition, by purchasing network elements, entrants can better prepare for a day  
2 when alternative networks offer the opportunity to obtain network capacity (i.e.,  
3 elements) from other vendors.  
4

5 **Q. WILL THE ABILITY TO INNOVATE USING NETWORK ELEMENTS**  
6 **INCREASE IN THE FUTURE?**

7 A. Yes. The introduction of Advanced Intelligent Network (AIN) capability will  
8 transform the local switch from a service-definition node to a more generic role. In  
9 the future, service-defining capabilities will be housed in remote software databases  
10 which provide call processing instructions to the switch. The innovation possible in  
11 this environment -- an environment roughly analogous to the innovation unleashed  
12 when the personal computer freed the software industry from IBM -- is limitless, but  
13 only if the network facilities which interact with these databases can be efficiently  
14 obtained and combined to provide service.  
15

16 **Q. DOESN'T SERVICE-RESALE PROVIDE THE ENTRANT THE SAME**  
17 **FLEXIBILITY?**

18 A. No. Service-resale, by definition, limits the entrant to reoffering finished services  
19 created by the incumbent LEC. Even where the entrant *superficially* appears to  
20 have an ability to modify an incumbent LEC service -- for instance, by including an  
21 optional feature as a standard element -- there is little *practical* flexibility because  
22 the entrant's cost structure is defined by the incumbent LEC's retail price. With no  
23 economic flexibility, there is little the entrant can do to introduce new pricing  
24 arrangements or feature mixes.  
25

1 This limitation on the entrant is most apparent when considered in the context of the  
2 local switching network element. By purchasing the switch as a network element,  
3 the entrant incurs the same economic cost as the incumbent LEC; paying in advance  
4 the cost of the switch's features as *potential* services to end users. Having incurred  
5 the cost of *all* potential features, the entrant must then price its services to balance  
6 the dual objectives of market penetration and profitability.

7  
8 **Q. PLEASE SUMMARIZE THE KEY DIFFERENCES BETWEEN SERVICE-  
9 RESALE AND NETWORK ELEMENT-BASED COMPETITION.**

10 A. Service-resale establishes the entrant as the incumbent LEC's marketing agent,  
11 essentially offering identical services, with little to no ability to offer lower prices.  
12 If a carrier has no interest in designing unique services, has no reason to offer both  
13 local exchange and exchange access service, has no desire to compete aggressively  
14 with BellSouth's prices, and has no intention to replace individual network  
15 components with the facilities of other carriers (or its own) as they become  
16 available, then service-resale is the ideal solution.

17  
18 While service-resale will provide carriers a *simple* entry option -- and, for that  
19 reason, the Commission can expect that many carriers will use this approach,  
20 particularly at first -- robust local competition depends upon the more challenging  
21 opportunities made possible by network element combinations. Network elements  
22 permit the entrant to design its own services, they establish the entrant as both local  
23 exchange and exchange access provider, they position the entrant for facilities  
24 replacement and they present the entrant with the same economic pricing choices as  
25 BellSouth.



1                   **THE NETWORK ELEMENT PURCHASER IS THE ACCESS PROVIDER**

2

3   **Q.   PLEASE SUMMARIZE BELLSOUTH'S POSITION REGARDING THE**  
4           **RELATIONSHIP BETWEEN ACCESS SERVICE AND NETWORK**  
5           **ELEMENT-BASED COMPETITION.**

6   **A.**   BellSouth's position (Varner, page 21-22) is that it is entitled to an access  
7           monopoly, even to end-users that have changed local carriers. To retain this  
8           monopoly -- or, at the least, all the benefits of being a monopoly -- BellSouth asks  
9           the Commission to take two actions.

10

11           First, BellSouth recommends that the Commission consider taking an action "... to  
12           offset any loss of contribution previously provided by *interstate* access charges."

13           Mr. Varner's testimony never explains exactly what he means by this request, nor  
14           does he offer a policy justification or legal basis to permanently guarantee BellSouth  
15           these revenues. Because it is not clear that Mr. Varner is serious about this request,  
16           I do not address it further in my rebuttal.

17

18           Second, and with more discussion, Mr. Varner asks that the Commission use its  
19           "pricing authority" to perpetuate BellSouth's intrastate access monopoly by allowing  
20           BellSouth to continue to collect access charges on the use of the facilities that it has  
21           already leased to a competitor. As the testimony below explains, BellSouth's  
22           request is not a "pricing issue", but is instead a direct challenge to the basic role of a  
23           "network element" contained in the Act and applicable FCC rules.

24

25

1 **Q. PLEASE EXPLAIN THE BASIC ROLE OF THE "NETWORK ELEMENT"**  
2 **UNDER THE FRAMEWORK IN THE FEDERAL ACT.**

3 A. A central premise of the federal Act is that an entrant (i.e., a requesting carrier) may  
4 obtain network elements to provide whatever array of services it desires. Section  
5 251(c)(3) describes BellSouth's obligation to provide network elements as:

6

7 The duty to provide, to any requesting telecommunications  
8 carrier for the provision of a telecommunications service,  
9 nondiscriminatory access to network elements ...

10

11 The FCC rules which implement Section 251 reaffirm this central principle. For  
12 instance, CFR §51.307(c) states (emphasis added):

13

14 (c) An incumbent LEC shall provide a requesting  
15 telecommunications carrier access to any unbundled network  
16 element, along with all of the unbundled network element's  
17 features, functions, and capabilities, in a manner that allows  
18 the requesting telecommunications carrier to provide *any*  
19 telecommunications service that can be offered by means of  
20 that network element.

21

22 **Q. ARE THERE OTHER RULE PROVISIONS WHICH MAKE CLEAR THAT**  
23 **THE ENTRANT HAS THE RIGHT TO USE THE NETWORK ELEMENTS**  
24 **TO PROVIDE ANY SERVICE, INCLUDING ACCESS SERVICE?**

25 A. Yes. The following FCC rules, undisturbed by the Eighth Circuit's decision, clearly

1 establish that the entrant may use network elements for this (or any) purpose:

2  
3 47 C. F. R. § 51.309. - Use of Unbundled Network Elements

4 (a) An incumbent LEC shall not impose limitations,  
5 restrictions, or requirements on requests for, or the  
6 use of, unbundled network elements that would  
7 impair the ability of a requesting telecommunications  
8 carrier to offer a telecommunications service in the  
9 manner the requesting telecommunications carrier  
10 intends.

11  
12 (b) A telecommunications carrier purchasing access to an  
13 unbundled network element may use such network  
14 element to provide exchange access services to itself  
15 in order to provide interexchange services to  
16 subscribers.

17  
18 **Q. DO THESE FCC RULES APPLY ONLY TO THE *INTERSTATE* SERVICES**  
19 **THAT WILL BE OFFERED USING NETWORK ELEMENTS?**

20 A. No. The Act's provisions defining network elements -- as well as the FCC rules  
21 implementing that authority -- are non-jurisdictional. That is, the entrant's right to  
22 use network elements to provide *any* service includes intrastate services (such as  
23 local service and intrastate access). After all, the Act adopted a national blueprint  
24 for *local* competition -- a framework that would have been meaningless if its  
25 provisions applied only to the use of network elements to provide interstate services.

1 FCC orders and effective federal rules clearly establish the entrant as the provider of  
2 access services with respect to its end-users -- and this conclusion would apply  
3 equally to both interstate and intrastate access.  
4

5 **Q. HAS THE FCC ADDRESSED THE ENTRANT'S ABILITY TO BECOME**  
6 **THE ACCESS-PROVIDER TO ITS OWN CUSTOMERS?**

7 A. Yes. The FCC has reiterated through a series of orders that the roles of local  
8 provider (to the end-user) and access-provider (to other carriers) go hand-in-hand.  
9 In its initial decision defining network elements issued August 8, 1996 in Docket  
10 96-98 (paragraph 356), the FCC concluded:

11  
12 We confirm our tentative conclusion in the NPRM that  
13 section 251(c)(3) permits interexchange carriers and all other  
14 requesting carriers, to purchase unbundled elements for the  
15 purpose of offering exchange access services, or for the  
16 purpose of providing exchange access services to themselves  
17 in order to provide interexchange services to consumers.  
18

19 Furthermore, in this same order, the FCC explicitly defined the loop network  
20 element to establish the entrant as the exclusive provider of all services using the  
21 loop (paragraph 385):  
22

23 Giving competing carriers *exclusive* control over network  
24 facilities dedicated to particular end users provides such  
25 carriers the maximum flexibility to offer new service to such

1 end-users. In contrast, a definition of a loop element that  
2 allows simultaneous access to the loop facility would  
3 preclude the provision of certain services in favor of others.

4  
5 Finally, on September 27, 1996, the FCC issued a Order on Reconsideration in  
6 Docket 96-98 (paragraph 11), that extended this principle to the local switching  
7 network element in recognition of its indivisible nature:

8  
9 ... when a requesting carrier purchases the unbundled local  
10 switching element, it obtains all switching features in a  
11 single [network] element on a per-line basis ... Thus, a carrier  
12 that purchases the unbundled local switching element to  
13 serve an end user effectively obtains *the exclusive right* to  
14 provide all features, functions, and capabilities of the switch,  
15 including switching for exchange access and local exchange  
16 service, for that end user.

17  
18 Consequently, the FCC rules defining the loop and switch network elements  
19 establish the purchasing carrier as a complete provider of local exchange and access  
20 services.

21  
22 **Q. HOW DOES BELLSOUTH'S REQUEST FOR AN INTRASTATE ACCESS**  
23 **MONOPOLY SQUARE WITH THESE DEFINITIONS?**

24 A. BellSouth proposal to retain intrastate access cannot be squared with its obligations  
25 under the Act, its compliance with FCC rules, or even the cost methodology

1 underlying the prices charged for these network elements. BellSouth's position  
2 effectively redefines the loop/switch network elements to only provide the entrant  
3 with the functionality to provide *some* services (presumably local services and  
4 interstate access), but that BellSouth somehow retains the functionality to offer  
5 others (intrastate access). This perspective, however, violates that basic definition  
6 of these elements as the lease of *all* functionality to the entrant.

7  
8 Furthermore, at the urging of the ILECs, the FCC specifically rejected defining  
9 these elements in a manner which *would have* allowed the functionality to provide  
10 exchange access to exist independently of local service:

11  
12 We decline to define a loop element in functional terms,  
13 rather than in terms of the facility itself ... this definition  
14 would enable an IXC to purchase a loop element solely for  
15 purposes of providing interexchange service. While such a  
16 definition, based on the types of traffic provided over a  
17 facility, may allow for the separation of the costs for a  
18 facility dedicated to one end user, we conclude that such  
19 treatment is inappropriate. (Order, Docket 96-98, paragraph  
20 385.)

21  
22 \*\*\*

23  
24 We thus make clear, as a practical matter, a carrier that  
25 purchases an unbundled switching element will not be able

1 to provide solely interexchange service or solely access  
2 service to an interexchange carrier. (Order on  
3 Reconsideration, paragraph 13.)  
4

5 BellSouth cannot have it both ways -- if BellSouth could *retain* the functionality to  
6 provide only exchange access, then it should also *offer* this same functionality as a  
7 network element to others. The fact is that the loop/switch network elements  
8 embrace *all* the functionality of these facilities and BellSouth's request to retain an  
9 intrastate access monopoly must be rejected.  
10

11 **Q. ARE BELLSOUTH'S COST STUDIES CONSISTENT WITH ITS**  
12 **POSITION IN THIS DOCKET?**

13 A. No, not to my knowledge. BellSouth's network element cost studies typically (and  
14 appropriately) consider the cost of the loop in its entirety. They are not (and should  
15 not be) structured to allocate this cost to different services, particularly with the  
16 intention that BellSouth could then demand an exclusive right to offer a service of  
17 its choosing (such as intrastate access).  
18

19 **Q. WHAT IS THE RELATIONSHIP BETWEEN THESE RULES AND THE**  
20 **FLORIDA COMMISSION'S PRICING AUTHORITY?**

21 A. As explained above, the FCC is responsible for defining the minimum set of  
22 network elements that BellSouth must offer. The Florida Commission is  
23 responsible for determining the prices that BellSouth will charge for these elements,  
24 subject to the requirement that the prices must be cost-based. The FCC has defined  
25 network elements in a manner which establishes the entrant as access provider. The

1 Florida Commission has established cost-based prices that fully compensate  
2 BellSouth for the cost of these facilities. There is no room to entertain, much less  
3 accommodate, BellSouth's request to retain an intrastate access monopoly.  
4

5 **Q. DOES THE FLORIDA STATE STATUTE AFFECT THIS ANALYSIS IN**  
6 **ANY WAY?**

7 A. No. The Florida statute does include a provision (364.16(3)(b)) which requires that  
8 a carrier which terminates interexchange traffic to another carrier through an  
9 interconnection agreement must pay the applicable access charge (if different than  
10 the rate to terminate local traffic). This effect of this provision does not alter which  
11 carrier is entitled to the compensation (it is the ALEC), it only requires that the  
12 appropriate charge apply. In the context of a network element-based entrant, the  
13 entrant is the ALEC with respect to its end-users and BellSouth is required to  
14 compensate the ALEC at the appropriate access/local termination rate for the traffic  
15 that BellSouth terminates to its end-users.  
16

17 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

18 A. Yes.  
19  
20  
21  
22  
23  
24  
25



**Comparing the Potential Benefit  
of Service-Resale and Network Element-Based Competition  
for the Typical Florida Residential Consumer<sup>1</sup>**

**Summary**

	Revenue	Cost	Gross Margin
Service-Resale	\$21.19	\$16.58	\$4.61
Network Elements	\$35.30	\$26.33	\$8.97
Additional Consumer Benefit			\$4.36

**Gross Margin Analysis: Service-Resale**

	Revenues	Costs	Gross Margin
Basic Local Service	\$10.65	\$8.33	
Call Waiting	\$4.00	\$3.13	
Call Forward Variable	\$3.00	\$2.35	
IntraLATA Toll/ECS	\$3.54	\$2.77	
Total	\$21.19	\$16.58	\$4.61

---

<sup>1</sup> The analysis in this exhibit is developed from the revenue/cost information for a typical residential customer sponsored by BellSouth witness Varner, Chart C to Exhibit AJV-1.

**Gross Margin Analysis: Network Element Combination**

Revenue Analysis		Cost Analysis	
<b>End User Market</b>			
Basic Local Service	\$10.65		
Call Waiting	\$4.00	<b>Network Element</b>	
Call Forward Variable	\$3.00	Loop	\$17.00
IntraLATA Toll/ECS	\$3.54	Local Switch	
Subscriber Line Charges	\$3.50	Port	\$2.00
<b>Access Market</b>		Usage <sup>2</sup>	\$5.93
Interstate Access	\$7.05	Transport/Termination <sup>2</sup>	\$1.40
Intrastate Access	\$3.56		
<b>Total Revenues</b>	<b>\$35.30</b>	<b>Total Cost</b>	<b>\$26.33</b>

<sup>2</sup> Mr. Varner's exhibit does not clearly attribute costs to particular network elements. To maintain consistency with Mr. Varner's exhibit, I have assume that his "local usage" entry is related to the use of the local switching network element and that the cost he labels "Toll/ECS" refers to the cost to transport and terminate calls on the interoffice network. The cost of each of these network elements has been increased to include an estimate of the additional minutes purchased by the entrant to provide interstate and intrastate switched access services. These additional costs were estimated by increasing Mr. Varner's total cost for "local usage" and "Toll/ECS" by a factor reflecting the relationship of access-minutes/local&toll minutes developed from BellSouth's 1993 separations study (reported to the FCC).

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