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RECORDS AND
REPORTING

September 2, 1998

Mrs. Blanca S. Bayó
Director, Division of Records and Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

Re: Docket No. 980696-TP

Dear Ms. Bayó:

Enclosed is an original and fifteen copies of BellSouth Telecommunications, Inc.'s Rebuttal Testimony of Dr. Randall S. Billingsley, Dr. Robert M. Bowman, D. Daonne Caldwell, G. David Cunningham, Dr. Kevin Duffy-Deno, Georgetown Consulting Group, Peter F. Martin and Dr. William E. Taylor, which we ask that you file in the captioned matter.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served to the parties shown on the attached Certificate of Service.

Sincerely,

J. Phillip Carver
J. Phillip Carver (ps)

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Enclosures

cc: All parties of record
A. M. Lombardo
R. G. Beatty
William J. Ellenberg II (w/o enclosures)

Bowman Caldwell

Cunningham

Duffy-Deno

09612 SEP-28

09613 SEP-28

09614 SEP-28

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Martin DOCUMENT NUMBER - DATE
09617 SEP-28
Jaylor DOCUMENT NUMBER - DATE
09618 SEP-28
Georgetown DOCUMENT NUMBER - DATE
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Billingsley DOCUMENT NUMBER - DATE

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DOCKET NO. 980696-TP (HB4785)**

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(+) Protective Agreements

ORIGINAL

1 BELLSOUTH TELECOMMUNICATIONS, INC.
2 REBUTTAL TESTIMONY OF PETER F. MARTIN
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

4 DOCKET NO. 980696-TP

5 SEPTEMBER 2, 1998

6
7 I. INTRODUCTION

8
9 Q. PLEASE STATE YOUR NAME, ADDRESS AND POSITION WITH
10 BELLSOUTH TELECOMMUNICATIONS, INC. (HEREINAFTER
11 REFERRED TO AS "BELLSOUTH" OR "THE COMPANY").

12
13 A. My name is Peter F. Martin and I am employed by BellSouth as a Director in
14 Regulatory. My business address is 675 West Peachtree Street, Atlanta, Georgia
15 30375.

16
17 Q. ARE YOU THE SAME PETER F. MARTIN WHO FILED DIRECT
18 TESTIMONY IN THIS DOCKET?

19
20 A. Yes, I am.

21
22 II. PURPOSE AND SUMMARY

23
24 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY BEING FILED TODAY?
25

DOCUMENT NUMBER-DATE

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1 A. The purpose of my testimony is to rebut certain issues raised in Joseph Gillan's
2 (Florida Competitive Carriers Association - "FCCA") and Richard Guepe's
3 (AT&T) direct testimonies.
4

5 Q. PLEASE COMMENT GENERALLY ON THE DIRECT TESTIMONY FILED
6 ON AUGUST 3, 1998.
7

8 A. Mr. Gillan and Mr. Guepe have addressed matters outside the scope of this
9 proceeding. BellSouth prepared its direct case in response to the issues as ordered
10 on July 24, 1998 as did most of the other parties. However, AT&T and the FCCA
11 have taken this opportunity to address issues that will necessarily be considered in
12 future proceedings by this Commission or the Legislature. The issues list for this
13 proceeding was very specific. Since the nature of the issues raised by AT&T and
14 FCCA bears directly on the establishment of a sufficient and explicit state
15 universal service fund, BellSouth must respond and I am compelled to address
16 these issues herein. Dr. William Taylor, of National Economic Research
17 Associates, Inc, also rebuts the testimony of Messrs. Guepe and Gillan.
18

19 The Commission need not address these parties' comments or BellSouth's replies
20 on these outside matters at this time, but the Commission should hold these
21 matters for the appropriate proceeding that will follow.
22

23 Q. MR. GILLAN, AT PAGE 2 OF HIS DIRECT TESTIMONY, STATES THAT
24 THE PRINCIPAL MOTIVATOR OF UNIVERSAL SERVICE IS PROFIT
25 INCENTIVES. DO YOU AGREE?

1 A. Certainly not. The principal motivator of universal service is the public policy
2 goal of providing local telephone service to all consumers at an "affordable" rate.
3 Over the past few decades, state commissions have adopted local service rates to
4 consumers that are below the costs to provide such service and have further
5 required the local exchange companies to provide service to all consumers in their
6 service areas. This policy has resulted in a 94 percent penetration level
7 nationwide for telephone service. Such a policy was sustainable in a monopoly
8 environment, but it will not work in a competitive environment when new entrants
9 can cherry pick the most profitable customers--those customers that have
10 traditionally provided support for basic local exchange service.

11
12 A fair and sustainable way to fund universal service in a competitive environment
13 must be established, one which does not fall only on the incumbent local
14 exchange company. Since universal service reform is revenue neutral to local
15 exchange companies upon implementation, there is no profit incentive to create a
16 universal service fund as Mr. Gillan alleges

17
18 In addition, in a competitive environment, all telecommunications service
19 providers should pay their fair share to support the funding of universal service.
20 If implicit subsidies remain in one provider's rates but are not found in another's
21 rates, it is hardly competitively neutral.

22
23 Q. MR. GILLAN ALSO SUGGESTS IN HIS DIRECT TESTIMONY THAT THE
24 COSTS OF THE FAMILY OF RESIDENTIAL SERVICES SHOULD BE

1 COMPARED TO THE REVENUES PROVIDED BY THESE SERVICES TO
2 DETERMINE THE NEED FOR A SUBSIDY (PAGE 3). DO YOU AGREE?

3
4 A. No. This misplaced suggestion would only continue the implicit subsidies
5 currently in vertical services, toll, and other services in direct contravention to the
6 intent of the 1996 Telecommunications Act ("Act") which directs that implicit
7 subsidies be replaced by explicit subsidies. If implicit subsidies remain in an
8 incumbent local exchange company's rates, competitive neutrality cannot be
9 achieved. Support for consumers in high cost areas must be available to all
10 eligible telecommunications companies, both large and small, from a universal
11 service fund. This is only possible with a fund based upon explicit support from
12 all telecommunications carriers. Neither competitive neutrality nor portability can
13 be achieved as long as implicit subsidies remain in an incumbent local exchange
14 carrier's (ILEC) rates.

15
16 Also, Mr. Gillan's suggested analysis would not consider the significant number
17 of BellSouth's customers who do not purchase any discretionary services, and
18 therefore do not provide any contribution to universal service. Indeed, in its News
19 Release of August 14, 1998, AT&T indicated that it was instituting a \$3 minimum
20 monthly charge. According to AT&T, in any month, 15 percent of its new
21 customers spend less than \$3 per month. It is hypocritical to suggest that
22 incumbent local exchange companies should not be able to recover the cost of
23 providing basic service to its below cost customers when carriers like AT&T are
24 now imposing minimum charges on their customers in an effort to either recover
25 their costs or to drive their low revenue customers away.

1 Q. IS MR. GILLAN'S RECOMMENDATION THAT THE COMMISSION
2 ADOPT A COST STUDY WHICH INCLUDES A "FAMILY OF SERVICES"
3 A REASONABLE INTERPRETATION OF FLORIDA STATUTE 364.025
4 (PAGE 3)?

5
6 A. No. Florida Statutes 364.25 specifically states:

7 "Basic local telecommunications service" means voice-grade, flat-rate
8 residential, and flat-rate single-line business local exchange services
9 which provide dial tone, local usage necessary to place unlimited calls
10 within a local exchange area, dual tone multi-frequency dialing, and
11 access to the following: emergency services such as "911," all locally
12 available interexchange companies, directory assistance, operator
13 services, relay services, and an alphabetical directory listing. For a
14 local exchange telecommunications company, such term shall include
15 any extended area service routes, and extended calling service in
16 existence or ordered by the commission on or before July 1, 1995."

17

18 The Florida Statute is specific and does not include optional calling, access
19 service and vertical services.

20

21 Q. DOES THE HAI MODEL INCLUDE "THE FULL COST OF THE LOOP AND
22 SWITCH TO PROVIDE ALL SERVICES THAT CAN BE FURNISHED TO
23 CONSUMERS" AS SUGGESTED BY MR. GUEPE AT PAGE 7?

24

1 A. No. The HAI model only includes the cost for supported services. On page 1 of
2 the HAI Model Release 5.0a Model Description attached to Mr. Don Wood's
3 direct testimony, it states: "The HAI Model uses the definition of basic local
4 telephone service adopted by the Federal-State Joint Board on Universal Service
5 ("Joint Board") for universal service funding purposes." Mr. Guepe would have
6 you think that all the costs for his residential family of services is included in their
7 model when it is not. For example, the HAI model does not include variable costs
8 associated with providing access service.

9

10 Q. MR. GILLAN FURTHER SUGGESTS IN HIS DIRECT TESTIMONY (AT
11 PAGE 7) THAT IT IS NOT POSSIBLE TO CONDUCT A COST STUDY
12 LIMITED TO "DIAL TONE" LOCAL SERVICE WITHOUT IMPLICATING
13 OTHER SERVICES. DO YOU AGREE?

14

15 A. No. The Benchmark Cost Proxy Model (BCPM), as well other cost proxy
16 models, are designed to estimate the cost of providing basic local service. Indeed,
17 the criteria set out in the Federal Communications Commission's (FCC) Universal
18 Service Order (para. 250) does not require the models to include or calculate the
19 cost of other services in the model. Determination of the cost of other services is
20 not necessary to calculate the cost of basic local telecommunications service. The
21 local loop is not a shared cost as some would contend. Dr. Taylor addresses the
22 concept of shared cost in his testimony.

23

24 Q. DO YOU AGREE WITH MR. GILLAN'S TESTIMONY AT PAGE 11 THAT
25 THERE IS NO COMPETITION IN THE STATE OF FLORIDA?

1 A. No. Many competitors have entered the State of Florida and provide
2 telecommunications services. As of August 1, 1998, over two hundred alternative
3 local exchange carriers have been certificated and another thirty have applications
4 pending. These competitors are targeting the very customers and services that
5 contain implicit subsidies that support universal service – business, access and
6 local toll. The exposure of universal service subsidies to deterioration by these
7 competitors is significant. The loss of BellSouth's top 10 percent of business
8 customers would represent more than 60 percent of our business revenues. These
9 current business revenues have allowed local rates to remain very low in Florida.

10
11 Competitors have also entered the residence market. For example, Media One is
12 offering local residential service in Jacksonville over its cable network. The
13 pricing structure of Media One has typically been such that it does not attract
14 customers who only buy basic service. Media One seems generally to target the
15 higher revenue customers, once again leaving low-revenue customers to the
16 incumbent provider.

17
18 Q. MR. GILLAN SUGGESTS THAT BASIC LOCAL TELECOMMUNICATIONS
19 SERVICE IS A LOSS LEADER TO OTHER SERVICE OFFERINGS SIMILAR
20 TO GETTING A FREE CELLULAR PHONE WHEN SIGNING UP FOR
21 CELLULAR SERVICE. DO YOU CONCUR?

22
23 A. No. His comparison overlooks a major difference between cellular service and
24 basic telephone service.

25

1 A cellular telephone is useless without the service provider. The cellular service
2 provider will not give you the free phone unless you commit to a contract for
3 some specified period of time. Thus, the cellular provider is assured of getting a
4 certain level of revenues. In contrast, basic local telecommunications service is
5 functional without any other services required and many of our customers do not
6 purchase additional services. BellSouth cannot require that customers purchase
7 basic service in combination with other services nor can it require subscribers to
8 execute contracts which lock in customers for a period of time. Thus, unlike with
9 the cellular packages, there is a significant likelihood that some customers will be
10 unprofitable.

11

12 Q. ARE THE REVENUES FROM TOLL, VERTICAL SERVICES AND ACCESS
13 EVENLY DISTRIBUTED AMONG ALL CUSTOMERS, AND IF NOT, WHAT
14 ARE THE IMPLICATIONS ON UNIVERSAL SERVICE?

15

16 A. The revenues are *not* evenly distributed. We have found that 41 percent of
17 BellSouth's residential customers in Florida take no vertical services. When you
18 include those residential customers who subscribe to only one vertical service the
19 percentage increases to 65 percent. Toll revenues are even more skewed. Indeed,
20 some 82% of BellSouth's residential customers make no intralata toll calls during
21 a month. Thus, a small subset of BellSouth's residential customers accounts for a
22 large share of discretionary revenues. It is these customers that competitors will
23 seek out. Competitors will not seek to serve those customers with minimal
24 discretionary service revenues. Competitors will leave these customers to the
25 incumbent LEC. Meanwhile, as the competitors win over the more lucrative

1 customers, the implicit subsidies available to support universal service will
2 "shrink". Universal service in Florida will be jeopardized.

3
4 Q. WHAT SHOULD BE THE APPROPRIATE BENCHMARK FOR
5 CALCULATION OF UNIVERSAL SERVICE SUPPORT AS OPPOSED TO
6 THE BENCHMARK PROPOSED BY MR. GUEPE AT PAGE 14 OF HIS
7 TESTIMONY?

8
9 A. The appropriate benchmark for universal service is the maximum rate for the
10 services which comprise universal service including the subscriber line charge and
11 mandatory EAS and zone charges. The inclusion of access, toll and vertical
12 service revenue in the benchmark would only enable the implicit subsidies that
13 are to be made explicit.

14
15 In a book entitled Letting Go: Deregulating the Process of Deregulation, Dr.
16 Alfred Kahn makes the point that facilities based competition is doomed if the
17 subsidies for below cost services are insufficient. He states as follows:

18 As the [FCC] Commission explicitly recognizes, to its credit, the
19 competition that it is our national policy to encourage makes the
20 overpricing of the subsidizing services unsustainable. Moreover, the
21 way in which the Telecommunications Act and the FCC's interpretation
22 of it has proceeded to make those cross-subsidies unsustainable ensures
23 that competitors will not enter into the local markets *on a facilities basis*
24 unless the subsidies are sufficient to make up the difference between the

1 suppressed rates and the incremental costs (or efficient prices) of
2 providing *basic service* itself. (Author emphasized with Italics.)
3 (Letting Go: Deregulating the Process of Deregulation, Alfred E. Kahn,
4 MSU Public Utilities Papers, 1998, page 128.)
5

6 Inflating the benchmark for universal service by including additional revenues
7 other than those for basic local telecommunications service will create an
8 insufficient explicit subsidy. Besides violating the Act, Dr. Kahn notes that an
9 insufficient explicit subsidy will harm facilities-based competition.
10

11 Q. MR. GUEPE REPORTS THAT THE COST OF UNIVERSAL SERVICE FOR
12 BELLSOUTH IS \$680.6 MILLION WHICH EQUATES TO ONLY \$15.11 PER
13 RESIDENCE LINE PER MONTH (PAGE 12). PLEASE COMMENT.
14

15 A. These numbers do not pass the common sense test. If it only costs \$15.11 per
16 residence line per month in Florida then why isn't AT&T building out a network
17 in Florida and providing residential service? By constructing a facilities-based
18 network, AT&T could avoid paying access charges and provide the supported
19 services. The revenues it would collect would certainly exceed \$15.11 per line
20 (especially if vertical services are included, per AT&T's recommendation).
21 Indeed, the HAI Model shows costs of \$11.00 or less per month in some of the
22 Miami wire centers. Yet, AT&T is not providing residential basic service in any
23 of these wire centers. Last year, AT&T stopped its efforts to enter the residential
24 market after losing millions of dollars. If AT&T based its initial entry decision on
25 similarly unrealistically low cost figures, it may very well explain these losses.

1 Q. IN DEFENSE OF HIS POSITION, MR. GILLAN SUGGESTS THAT THE
2 FLORIDA STATUTES ARE INCONSISTENT AND AMBIGUOUS IN
3 REGARD TO THE DEFINITION OF "BASIC LOCAL
4 TELECOMMUNICATIONS SERVICE" (PAGES 16 AND 17). DO YOU
5 CONCUR?

6
7 A. No. The statute is clear and succinct. The difficulty is Mr. Gillan's twisted
8 interpretation. The Florida Legislature has (1) specifically defined basic local
9 telecommunications service in Section 364.025 F. S., (2) requested the
10 Commission to report on the cost of basic local telecommunications service by
11 February 15, 1999, and (3) will use this information to establish a permanent
12 universal service mechanism for the state. It is hard to imagine the instructions
13 being any more clear and unambiguous.

14
15 Q. IS IT APPROPRIATE AS MR. GILLAN (PAGE 20) AND MR. GUEPE (PAGE
16 10) ASSERT, TO USE THE SAME LEVEL OF AGGREGATION FOR
17 MODELS WHICH DETERMINE UNE RATES AND UNIVERSAL SERVICE
18 COSTS?

19
20 A. No. First of all, the calculation of unbundled network elements rates is
21 determined by costing out the equipment and services necessary to provide certain
22 network elements from an ILEC to an ALEC. These company specific
23 calculations are based on costs that have historically been averaged across the
24 ILEC's study area in order to smooth the rates across all areas of the state.
25 Therefore, until rates (especially business rates) are rebalanced at the state level, it

1 is not appropriate to disaggregate costs for unbundled network elements to an area
2 smaller than the study area. Business rates cannot be rebalanced until a sufficient
3 universal service fund is established.

4
5 Second, the cost proxy model for universal service is predicated on the
6 assumptions of an efficient provider constructing a network using "total forward-
7 looking cost, based upon the most recent commercially available technology and
8 equipment and generally accepted placement principles." The proxy models are
9 designed to calculate costs based on small geographic areas. The Legislature
10 correctly instructed the Commission to calculate these costs on a wire center
11 basis. Calculations at this level will better target necessary support and promote
12 efficient competitive entry of ALECs seeking universal service support by
13 limiting the area they must serve.

14
15 Q. PLEASE COMMENT FURTHER ON MR GILLAN'S DISCUSSION OF THE
16 GEOGRAPHIC BASIS OF CALCULATIONS FOR UNIVERSAL SERVICE
17 AND UNES.

18
19 A. Mr. Gillan's arguments for consistency are self-serving and contradictory. On
20 one hand, he argues that UNES should be deaveraged for all wire centers (at page
21 21) yet on the other, he argues that universal service costs should be calculated on
22 a statewide level (at page 22). It would appear that Mr. Gillan is only interested
23 in a wire center basis of calculation if it concerns UNES. Determining support for
24 universal service on a statewide basis would result in an insufficient fund. An
25 insufficient fund will disincent ALECs from ever competing for rural and high

1 A. Absolutely not. In this regard, the FCC adopted the principle of competitive
2 neutrality to ensure that it would show no preference to any provider. Universal
3 service support is fully portable to any eligible telecommunications company. It
4 is not a protected revenue source. AT&T is attempting to shield universal service
5 support from carriers in this proceeding since AT&T advocates that no universal
6 service support should be provided. Under AT&T's plan, no competition will
7 ever develop in rural and high cost areas since support will not be available to
8 new entrants.

9

10 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

11

12 A. This Commission should report to the Legislature the cost of universal service for
13 BellSouth as calculated by the BCPM 3.1 model with BellSouth inputs by wire
14 center. In addition, the testimony of Richard Guepe of AT&T and Joseph Gillan
15 of FCCA should be disallowed as I have outlined in this rebuttal testimony.
16 Similarly, rebuttal testimony contained herein that discusses Mr. Guepe's and Mr.
17 Gillan's direct testimony as well as Dr. Taylor's rebuttal testimony should be set
18 aside for a future proceeding on universal service.

19

20 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

21

22 A. Yes.

23

24

25