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BELLSOUTH TELECOMMUNICATIONS, INC.
REBUTTAL TESTIMONY OF ALPHONSO J. VARNER
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 990649-TP
SEPTEMBER 10, 1999

Q. PLEASE STATE YOUR NAME, BUSINESS NAME AND ADDRESS.

A. My name is Alphonso J. Varner. I am employed by BellSouth Telecommunications, Inc. ("BellSouth") as Senior Director for State Regulatory for the nine state BellSouth region. My business address is 675 West Peachtree Street, Atlanta, Georgia 30375.

Q. ARE YOU THE SAME ALPHONSO J. VARNER THAT FILED DIRECT TESTIMONY IN THIS DOCKET?

A. Yes. I filed direct testimony in this docket on August 11, 1999.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to portions of the direct testimonies of James C. Falvey of e.spire Communications, Inc. ("e.spire"), Julia O. Strow of Intermedia Communications Inc. ("ICI"), and Terry L. Murray of Covad Communications Company ("Covad"). In responding to the direct testimony of these witnesses, I address the following issues:

- 1 • deaveraged UNE prices;
- 2 • pricing of unbundled network elements (“UNEs”) and any currently
- 3 combined UNEs offered by BellSouth;
- 4 • loop and transport combinations (“extended loops”);
- 5 • unbundling of advanced services;
- 6 • UNEs at volume and term discounts.

7

8 **Deaveraged UNE Prices**

9 Q. SEVERAL OF THE PARTIES ADVOCATE DEAVERAGED UNE PRICES
10 IN THIS DOCKET. DO YOU AGREE?

11

12 A. No. While this proceeding initiates discussions regarding the appropriateness
13 of deaveraged UNE prices, careful consideration must be given to the timing of
14 implementing such pricing policy. Geographic deaveraging of UNE prices
15 should not be implemented until this Commission addresses the issues of
16 universal service and rate rebalancing. As I have discussed in other
17 proceedings and in my direct testimony in this docket, geographic deaveraging
18 presents several public policy issues that the Commission should address
19 before it is implemented. This Commission has already ruled that the Act can
20 be interpreted to allow geographic deaveraging of UNEs, but does not believe
21 it can be interpreted to require geographic deaveraging. (Order No. PSC-96-
22 1579-FOF-TP, page 23)

23

24 The FCC also recognized that this is not the appropriate time to implement
25 geographic deaveraging and that universal service issues must be dealt with

1 first. Even though the FCC has the latitude to require deaveraged prices
2 because its pricing rules are now in effect, on May 7, 1999 the FCC issued a
3 Stay Order in CC Docket No. 96-98. This stay delays the effectiveness of Rule
4 51.507(f) until six months after the Commission issues its order finalizing and
5 ordering implementation of high-cost universal service support for non-rural
6 LECs. Thus, as stated in my direct testimony, there is no requirement that
7 geographic deaveraging be implemented at this time, particularly with respect
8 to prices for currently combined UNEs.

9
10 Q. BEGINNING ON PAGE 4, MR. FALVEY STATES, "IN ORDER FOR
11 LOOP RATES TO BE TRULY COST-BASED, THEY CANNOT BE BASED
12 ON STATEWIDE AVERAGED COSTS BUT, RATHER, THEY MUST
13 REFLECT THE COSTS INCURRED IN RELEVANT DENSITY ZONES
14 WITHIN THE PARTICULAR STATE." PLEASE COMMENT.

15
16 A. Mr. Falvey's rationale is incorrect. If this rationale is taken to its logical
17 conclusion, Mr. Falvey would claim that there cannot be deaveraged prices
18 until the loop to each customer is priced at its cost. The fact is deaveraging is a
19 matter of degree; state is more deaveraged than nation, exchange is more
20 deaveraged than state, wire center is more deaveraged than exchange. Contrary
21 to Mr. Falvey's assertion, the anticompetitive practice is deaveraging loops
22 before the ILEC's local rates are rebalanced to permit both parties to compete
23 on a comparable footing.

24
25 Q. MR. FALVEY (PAGES 5 AND 7) ASSERTS THAT THE PRICING

1 STRUCTURE OF INTERSTATE SPECIAL ACCESS SERVICES SHOULD
2 BE THE BASIS FOR DEAVERAGED UNBUNDLED LOOP RATES.
3 PLEASE COMMENT.

4
5 A. The pricing structure of interstate special access service is irrelevant to the
6 pricing structure of UNEs. First, special access is not a UNE. Second, special
7 access and private line prices do not vary inversely related to cost the way local
8 service rates do. Rates for special access and private line services are not
9 necessarily based on cost, whereas, UNE rates have been set equal to costs by
10 this Commission.

11
12 Q. ON PAGE 7, MR. FALVEY STATES THAT DEAVERAGED RATES ARE
13 NECESSARY IN ORDER FOR UNE RATES TO BE COST-BASED.
14 PLEASE COMMENT.

15
16 A. Mr. Falvey is incorrect. First, this Commission has determined that the rates
17 BellSouth charges for UNEs are cost-based. Second, nowhere is there a
18 requirement that geographic deaveraged rates be in effect before USF is
19 implemented. In fact, the FCC tied the waiver of the deaveraging rule to USF
20 implementation.

21
22 **Pricing of UNEs and UNE Combinations offered by BellSouth**

23 Q. THE OTHER PARTIES TO THIS DOCKET SUGGEST THAT UNE
24 COMBINATIONS ORDERED IN THIS DOCKET SHOULD BE PRICED AT
25 TELRIC. PLEASE RESPOND.

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A. As I discussed in detail in my direct testimony, until the Federal Communications Commission ("FCC") completes its proceeding on its Rule 51.319 ("319 proceeding"), there is no required set of UNEs that must be made available individually or on a currently combined basis. BellSouth has advised the FCC that it will continue to provide all currently offered UNEs while the FCC conducts its proceeding. Thus, BellSouth is demonstrating its willingness to cooperate during this interim period so as not to create unnecessary disruption. BellSouth should not be required to provide unrestricted UNE combinations to ALECs at TELRIC prices, particularly in this interim period. BellSouth's position is consistent with the FCC's current rules, in that the FCC did not establish pricing rules to govern the provision of currently combined UNEs. As such, this Commission has the latitude and the opportunity to set prices for currently combined UNEs that are appropriate for Florida.

Q. SEVERAL PARTIES CONTEND THAT WITHOUT COMBINATIONS, THEY WILL BE IMPAIRED IN THE PROVISIONING OF ALL TELECOMMUNICATIONS SERVICES. PLEASE COMMENT.

A. If certain telecommunication services were not available to ALECs at all, their comments might have some validity. However, this is not the case. BellSouth makes its retail telecommunication services available to ALECs on a wholesale basis, which may be ordered from BellSouth's tariffs at the retail rate minus the applicable wholesale discount. Therefore, ALECs have the requested capability available to them; the only issue is price. If retail services are

1 available to ALECs at UNE prices, this simply provides ALECs a price break
2 on retail services that is funded by BellSouth's end user customers.

3

4 Importantly, should the Commission order the provision of any currently
5 combined UNEs, the underlying UNEs must meet the necessary and impair
6 standards of the 1996 Act. The Commission should expect that the FCC will
7 not require the provision of all UNEs originally required by the FCC's Rule
8 51.319. In addition, the Commission should weigh the impact of pricing for
9 currently combined UNEs on the development of facilities-based competition
10 in Florida. If this Commission wants to advance the public policy benefits of
11 competition, it cannot do so and price currently combined UNEs at cost.

12 Further, although the FCC's pricing rules have been reinstated, the Eighth
13 Circuit Court offered parties the opportunity to argue the merits of the pricing
14 rules that were not previously reviewed by the Court.

15

16 For these reasons, BellSouth recommends the Commission adopt a policy of
17 establishing prices for UNEs that, at a minimum, cover the full actual costs of
18 the elements, with prices for preexisting combinations of UNEs set at full
19 market value. The pricing of preexisting combinations of UNEs at full market
20 value would include a reasonable profit that is specifically permitted by the
21 1996 Act. Adopting prices that include a reasonable profit will promote
22 investment in the telecommunications infrastructure in Florida.

23

24 Q. IS THERE SUPPORT FOR BELLSOUTH'S POSITION THAT A
25 REASONABLE PROFIT IS APPROPRIATE FOR CURRENTLY

1 COMBINED UNES OFFERED BY BELLSOUTH?

2

3 A. Yes. As I stated in my direct testimony, this Commission has already
4 recognized that pricing combinations of UNEs at market levels may be
5 appropriate. For example, in addressing combinations of UNEs in the AT&T,
6 MCI and ACSI arbitration dockets, the Commission stated, "we note that we
7 would be very concerned if recombining network elements to recreate a service
8 could be used to undercut the resale price of the service." Order PSC-97-0298-
9 FOF-TP at p. 8. Subsequently, in Order No. PSC-98-0810-FOF-TP (Docket
10 No. 971140-TP), the Commission stated, "[w]e continue to find it troublesome
11 that a service provisioned through unbundled access would have all the
12 attributes of service resale but not be priced based on the Act's resale price
13 standard." Order at p. 25. Further, on the same page of that Order, the
14 Commission determined that UNE combinations should be priced at the sum of
15 the UNE prices "except when the network elements are combined in a way to
16 recreate an existing BellSouth retail service." [Emphasis added]. Order at p.
17 25.

18

19 **Provision of UNEs and Technical Feasibility**

20 Q. ICI AND E.SPIRE ERRONEOUSLY CONCLUDE THAT BELLSOUTH
21 MUST MAKE AVAILABLE TO ALECS ANY REQUESTED UNE OR UNE
22 COMBINATION THAT IS TECHNICALLY FEASIBLE TO PROVIDE. DO
23 YOU AGREE?

24

25 A. No. ICI and e.spire make the same mistake the FCC made when it also

1 interpreted the Act to require ILECs to provide all unbundled elements that are
2 technically feasible to provide. The Supreme Court held that the FCC's
3 interpretation of Section 251(c)(3) to mean whatever requested element can be
4 provided must be provided was wrong. The Supreme Court stated that "[t]he
5 FCC was content with its expansive methodology because of its
6 misunderstanding of §251(c)(3), which directs an incumbent to allow a
7 requesting carrier access to its network elements 'at any technically feasible
8 point.'" 525 U.S. __,142 L. Ed. 2d 834,856. (Emphasis added). The Supreme
9 Court agreed with the Eighth Circuit Court that stated, "[s]ection 251(c)(3)
10 indicates 'where unbundled access must occur, not which [network]elements
11 must be unbundled.'" Id. (Emphasis added).

12
13 Q. ICI AND E.SPIRE FURTHER SUGGEST THAT ANY UNE OR UNE
14 COMBINATIONS SHOULD BE MADE AVAILABLE SIMPLY BECAUSE
15 AN ALEC REQUESTS IT. PLEASE COMMENT.

16
17 A. The Supreme Court found that this position was also wrong and specifically
18 addressed this improper stance when it found a similar position taken by the
19 FCC to be wrong. The Court determined that the FCC, not ALECs, should
20 determine when an element meets the necessary and impair test. Referring to
21 the FCC's improper judgment, the Supreme Court noted, "that judgment
22 allows entrants, rather than the Commission, to determine whether access to
23 proprietary elements is necessary, and whether the failure to obtain access to
24 nonproprietary elements would impair the ability to provide services." 525
25 U.S. __,142 L. Ed. 2d 834,855. The Court went on to provide the FCC with

1 ample guidance as to how it should make such a determination.

2

3 By advising the FCC that it did not give adequate consideration to the
4 necessary and impair standards of the 1996 Act, the Supreme Court anticipated
5 that the FCC, not ALECs, would establish the UNEs that ILECs are required to
6 offer. If left to the ALECs to establish the required set of UNEs, BellSouth
7 would have to provide "blanket access" to any and every network capability.
8 Such action, however, is specifically what the Supreme Court sought to avoid
9 in vacating the FCC's Rule 51.319.

10

11 Q. ON PAGE 14, MS. STROW STATES THAT THIS COMMISSION IS
12 "EMPOWERED TO REQUIRE ILECs TO PROVIDE UNE
13 COMBINATIONS IN ANY MANNER IT SEES FIT." PLEASE
14 COMMENT.

15

16 A. Ms. Strow is mistaken. ILECs are not required to combine UNEs. The quote
17 of the Supreme Court's order that Ms. Strow refers to in her testimony simply
18 upholds the FCC's rule 51.315(b), not subparts (c-f). Rule 51.315(c-f) remains
19 vacated and as such, ILECs are not required to combine UNEs.

20

21 **Loop and Transport Combinations ("extended loops")**

22 Q. IN REQUESTING THAT ILECs PROVIDE ANY COMBINATION OF
23 UNES REQUESTED BY ALECS, ICI AND E.SPIRE PARTICULARLY
24 DEMAND THAT BELL SOUTH PROVIDE A COMBINATION OF LOOP
25 AND TRANSPORT OR "EXTENDED LOOP". PLEASE RESPOND.

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A. A request for an “extended loop” would require BellSouth to combine the loop and dedicated transport, a function that BellSouth is not required to perform. Because the FCC’s Rules 51.315(c-f) have been vacated, BellSouth is not required to combine UNEs for ALECs. In addition, until the FCC establishes the list of UNEs that meet the necessary and impair standards of the 1996 Act, Rule 51.315(b), which prohibits ILECs from disconnecting currently combined UNEs, cannot be implemented. Furthermore, ICI’s and e.spire’s claims that extended loops are technically feasible and therefore must be provided are misguided. As I discussed earlier in this testimony, the standard for provision of UNEs is not technical feasibility, but whether, through the FCC’s 319 proceeding, a UNE is determined to meet the necessary and impair test.

Q. WHAT ARE THE IMPLICATIONS OF PRICING CURRENTLY COMBINED UNEs AT THE SUM OF THE UNEs, AS REQUESTED BY ICI AND E.SPIRE?

A. Since currently combined UNEs that replicate private line and/or special access services create opportunities for price arbitrage and inhibit facilities-based competition, access to these combinations should not be unrestricted. In order to meet the goals of the 1996 Act, the Commission should adopt a pricing policy for currently combined UNEs that includes a reasonable profit and enables BellSouth to be compensated adequately for the use of its ubiquitous network.

1 Q. ICI AND E.SPIRE TAKE THE ISSUE OF EXTENDED LOOPS ONE STEP
2 FURTHER BY SUGGESTING THAT THE COMMISSION SHOULD
3 ESTABLISH A LOOP/TRANSPORT COMBINATION AS A SINGLE UNE.
4 DO YOU AGREE?

5

6 A. No. The unbundled loop and unbundled transport, as originally established
7 under the FCC's now vacated rule 51.319, are themselves single, distinct
8 elements. ICI argues that the loop and transport combination is a single UNE.
9 This position, however, is wrong. The FCC originally established transport as
10 a separate UNE, just as it established the loop as a distinct UNE. ICI can't
11 have it both ways; as separate UNEs or a single UNE. Either they are distinct
12 UNEs or they are not. BellSouth contends that the loop and transport are
13 separate capabilities, which it is not required to combine for ALECs. Once the
14 FCC establishes a final and nonappealable list of UNEs, it will be clear what
15 UNEs BellSouth is required to provide, and what pre-existing combinations
16 must remain combined.

17

18 *Unbundling of Advanced Services*

19 Q. COVAD'S WITNESS, MS. MURRAY, SUGGESTS THAT BELLSOUTH
20 SHOULD BE REQUIRED TO UNBUNDLE ADVANCED SERVICES
21 OFFERINGS. WHAT IS BELLSOUTH'S POSITION ON THIS ISSUE?

22

23 A. BellSouth should not be required to unbundle network elements (i.e., DSLAMs
24 and packet switches) used in the provision of its advanced services. As I
25 described in my direct testimony, advanced services clearly do not meet the

1 necessary and impair standards of the 1996 Act. The advanced services market
2 is just being created and BellSouth has no clear advantage. In fact, other
3 companies are leading suppliers of these services. ICI's witness, Ms. Strow,
4 supports this fact. As Ms. Strow espoused in her testimony, ICI provisions
5 many high-speed data services in Florida through its seven (7) ATM switches.
6 Both cable and wireless providers are ahead of ILECs in rolling out advanced
7 services. In its comments before the FCC in the 319 proceeding, BellSouth
8 stated, "[u]nbundling the wireline network while leaving directly competing
9 networks free of unbundling obligations would be a short-sighted,
10 fundamentally anti-consumer and anti-Congress act because it would substitute
11 regulation for competition instead of the reverse." (BellSouth's Comments, CC
12 Docket No. 96-98, dated May 26, 1999, page 33)

13
14 The FCC should find that network elements used in the provision of advanced
15 services, specifically digital subscriber line access multiplexer ("DSLAM") and
16 packet switches, do not meet the necessary and impair standards and, therefore,
17 will not be required to be unbundled. DSLAMs are equally available to ILECs
18 and ALECs from several vendors. ALEC relationships with well-funded
19 strategic partners, including the major IXCs, show that they are very unlikely to
20 be at any disadvantage to ILECs when it comes to purchasing DSLAMs.
21 Similarly, packet switches are available from several manufacturers and
22 ALECs have deployed numerous packet switches. In fact, ALECs can
23 maximize network efficiency by locating switches wherever they desire.
24 BellSouth, on the other hand, cannot provide service across LATA boundaries,
25 and must therefore locate packet switches within each of its LATAs.

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When the FCC looks outside the ILECs' networks and determines that actual competition exists for advanced services, it will become apparent that ALECs can successfully compete without the ILECs' facilities. Ms. Murray readily admits the existence of competition for advanced services through her statement on page 14 that "[t]he market for DSL-based services is unusual in that the incumbents do not already dominate it." Requiring unbundling under these circumstances will only result in reduced investment in Florida's telecommunications infrastructure and additional administrative cost burdens. ALECs will forego investing in their own equipment in many cases, given they can use ILEC DSLAMs and packet switches at cost-based prices. Due to the high risk of deploying facilities to offer new advanced services, a requirement to unbundle these services will likely cause ILECs to limit deployment because their investments will not provide a reasonable return for the risk involved. As C. Michael Armstrong, Chairman and CEO of AT&T stated in remarks before the Washington Metropolitan Cable Club on November 2, 1998, "no company will invest billions of dollars to become a facilities-based ... services provider if competitors who have not invested a penny of capital nor taken an ounce of risk can come along and get a free ride on the investments and risks of others."

UNEs at volume and term discounts

Q. MS. STROW OF ICI STATES THAT THIS COMMISSION SHOULD REQUIRE BELL SOUTH TO MAKE UNES AVAILABLE AT VOLUME AND TERM DISCOUNTS. DO YOU AGREE?

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A. No. BellSouth should not be required to provide volume and term discounts for UNEs. Neither the Act, nor any FCC order or rule, requires volume and term discount pricing. The UNE recurring rates that ALECs pay are cost-based in accordance with the requirements of Section 252(d) and are derived by using least-cost, forward looking technology consistent with the FCC's rules. Furthermore, BellSouth's nonrecurring rates already reflect any economies involved when multiple UNEs are ordered and provisioned at the same time. Volume and term discounts may be appropriate in some retail situations, but they are totally inappropriate in a UNE world where rates are already set at, or even below, the cost of the ILEC to provide the UNE.

Furthermore, the application of volume and term discounts would require a recalculation of the standard UNE prices, to reflect the loss of high-volume, long-term customers. For instance, if one customer segment (the volume and term discount segment) of the total UNE demand has lower costs (due to higher volumes or longer commitments), then the remainder of the total UNE demand has higher costs (due to lower volumes and shorter period commitments). If the low cost component of the UNE demand is removed from the calculation of the average cost and served at a separate lower price, the average cost for the remaining UNE demand would be impacted.

In this respect, a volume and term discount is similar to geographic deaveraging. For example, consider an average UNE cost of \$10, but the low cost segment (urban areas in geographic deaveraging or volume and term

1 discount) is \$8 and the high cost segment is \$12. If the low cost segment is
2 isolated, and charged a separate price, the cost of serving the remaining
3 segment (the high cost segment) is no longer \$10, rather, it is the now higher
4 \$12. It is mathematically impossible to isolate a low cost segment – without
5 causing the new average cost of the remainder to rise.

6

7 Moreover, there is certainly the potential that the UNE prices established will
8 be based on the costs that reflect the full economies of scale and the economies
9 of the term of commitment. In other words, UNE prices will already reflect
10 BellSouth's volumes and BellSouth's term commitment. Therefore, any
11 additional volume or term discount would be a fictitious reduction on costs that
12 already reflect the maximum volume and term discount.

13

14 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

15

16 A. Yes.

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