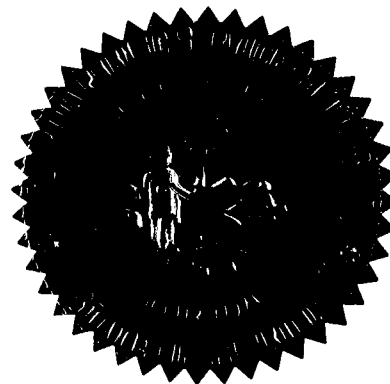


BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 010345-TP

In the Matter of

PETITION BY AT&T COMMUNICATIONS OF
THE SOUTHERN STATES, INC., TCG
SOUTH FLORIDA, AND MEDIAONE FLORIDA
TELECOMMUNICATIONS, INC. FOR
STRUCTURAL SEPARATION OF BELLSOUTH
TELECOMMUNICATIONS, INC. INTO TWO
DISTINCT WHOLESALE AND RETAIL
CORPORATE SUBSIDIARIES.



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VOLUME 2
Pages 110 through 267

PROCEEDINGS: WORKSHOP

BEFORE: CHAIRMAN E. LEON JACOBS, JR.
COMMISSIONER J. TERRY DEASON
COMMISSIONER LILA A. JABER
COMMISSIONER BRAULIO L. BAEZ
COMMISSIONER MICHAEL A. PALECKI

DATE: Monday, July 30, 2001

TIME: Commenced at 9:30 a.m.
Concluded at 5:40 p.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: KORETTA E. STANFORD, RPR
Official FPSC Reporter
(850) 413-6734

APPEARANCES: (As heretofore noted.)

FLORIDA PUBLIC SERVICE COMMISSION DOCUMENT NUMBER-DATE

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P R O C E E D I N G S

1
2 MS. LOGUE: Mr. Chairman, Commissioners, our next
3 presenter on behalf of FCCA will be Joe McGlothlin. Following
4 Mr. McGlothlin will be, also for FCCA, Mr. Joe Gillan.

5 MR. MCGLOTHLIN: Good afternoon. Is my microphone
6 working?

7 CHAIRMAN JACOBS: Yeah, I think, it is. Maybe you'll
8 want to turn it up a little bit. Can you turn it up a little
9 bit?

10 MR. MCGLOTHLIN: I'm addressing you now in my
11 capacity as attorney for the FCCA, which filed a supporting
12 request for an investigation of structural remedies. My
13 presentation is not on PowerPoint, but I hope you will see
14 power in these points.

15 CHAIRMAN JACOBS: Touche.

16 MR. MCGLOTHLIN: I propose to shrink my notes. The
17 result will not have the eloquent symmetry of the original, but
18 it will be shorter, so I think we'll go that way. I propose
19 simply to fill in and amplify some of the points that have been
20 made earlier and, basically, I'm going to use a broad brush to
21 hit some big themes.

22 As BellSouth's attorney mentioned at his outset, the
23 question of jurisdiction can be divided into questions of
24 whether the remedy requested is authorized by state law and
25 whether it is prohibited by federal law. And now we come to

1 the point of departure where I begin to disagree, but I'm going
2 to take the federal issues first.

3 My premise is, first of all, with respect to
4 questions such as preemption and commerce clause that have been
5 raised by BellSouth, the law has formulated certain tests to
6 tee those questions up. And the premise of my remarks to you,
7 Commissioners, is that based upon your knowledge of the
8 federal Act and how it interplays with your own
9 responsibilities under state law, just hearing the questions
10 asked will point you in the direction of the right answer.

11 For instance, with respect to preemption, there are
12 typically three questions that are raised. First, has the
13 federal government so completely occupied the field that
14 there's nothing left for the state to do? Second question,
15 will compliance with both the federal and state initiatives
16 frustrate the congressional intent? And thirdly, would the
17 proposed state measure run afoul of any specific preemption
18 provisions of the federal Act?

19 I've taken them one at a time. Has the federal
20 government completely occupied the field? Clearly, the answer
21 is no. The '96 Act retained the dual federal state regulatory
22 scheme. It, specifically, involved the state Commission's
23 implementation of the federal Act and also specifically
24 preserved state authority in some important respects.

25 And, Commissioner Jaber, in answer to one of the

1 questions that you raised earlier, the aspect of the federal
2 Act that preserves states authority, at least one of them, is
3 found in 261(c), which says that nothing precludes a state from
4 imposing requirements on a telecommunications carrier for
5 interstate services that are necessary to further competition
6 in the provision of telephone exchange service or exchange
7 access so long as the state's requirements are not inconsistent
8 with this part or the FCC's regulations to implement this part.

9 Now earlier, you posed this question: Does the fact
10 that the federal Act contemplates, specifically, structural
11 separation among limited subjects mean that it could have done
12 more but did not and, therefore, the state's precluded?

13 I ask you to consider this: If that were the test,
14 you would never have a situation in which the state can go
15 further than the federal government, because you will always be
16 confronted with the argument that, well, Congress could have
17 but didn't, therefore, you're precluded and that simply is not
18 the law. It's not the law specifically with respect to matters
19 exact nor is it the law generally with respect to the test of
20 preemption.

21 With respect to the commerce clause, typically, there
22 are two questions that formulate a test that is applied to
23 determine whether there is a violation of commerce clause.
24 First of all, does the measure directly regulate or
25 discriminate against interstate commerce or favor in-state

1 economic interests over out-of-state interests? And the second
2 question, if one survives the first, is the burden imposed on
3 interstate commerce excessive in relation to the punitive
4 benefits of the proposed measure?

5 Again, taking them one at a time, this measure does
6 not directly impact, regulate, or discriminate interstate
7 commerce; in fact, if anything, it enhances interstate
8 commerce. And secondly, with respect to the burden posed on
9 interstate commerce in relation to the benefits, we assert that
10 the benefits are huge and we also assert that you would be
11 hard-pressed to find any real burden on interstate commerce.

12 BellSouth referred you to a case, an Arizona case, in
13 which -- that involved a railroad situation, and the state's
14 scheme limited trains to x number of cars, I think, it was a
15 number of 12 cars. If you come into Arizona, you can't have
16 more than 12 cars. Well, clearly, that's going to affect the
17 way one conducts business in Arizona, as between other states,
18 and clearly it is going to complicate and be a burden on
19 interstate commerce on an ongoing basis and, I think, that's
20 key. But to require BellSouth to become separate wholesale
21 retail entities has no such impact on the way it does business
22 on an ongoing basis, nothing that impacts interstate commerce
23 to the detriment of interstate commerce.

24 Now, a lot of ground was covered earlier with respect
25 to laying out for you the specific aspects of state law that

1 provide a basis for the measure being considered. And, I
2 think, it all boils down to this: I think, BellSouth, and we
3 agree, that the test is what is necessarily implied? Granted
4 that you won't find the words structural separation explicitly
5 in the statute, but as they conceded, you're not limited to
6 those explicit measures. You also have available to you those
7 measures that are necessarily implied.

8 Well, with respect to the case law that BellSouth
9 offers on that subject and that which AT&T and FCCA offer, I
10 think, it's a real study in contrast. For instance, one of the
11 cases that BellSouth quoted was a 1909 case that said the
12 Commission did not have authority to require the railroad to
13 report the number of train wrecks. And I'll just ask you if
14 you want to extrapolate from that, carry it forward about a
15 century and do you really think that is representative of your
16 powers under Chapter 364. I submit to you that it has little
17 relationship to the appropriate interpretation of Chapter 364.

18 AT&T and FCCA decided to review the Teleco case and
19 that has been covered to some extent and I don't intend to go
20 over all aspects of that, but I recall that in his presentation
21 Mr. Lackey, while he acknowledged that I think the Court in
22 that case found some implied power, specifically, the power to
23 require that entity to divest itself of title to inside wiring,
24 argued also that in the same case that the Court drew a line
25 and there was an aspect of the Commission's action that it said

1 were in excess of its authority. Well, let's zero in on
2 exactly what that was.

3 Specifically, the Court said that the Commission
4 exceeded its authority when it attempted to, more or less,
5 adjudicate the contract rights between the entity that
6 installed and then leased the inside wiring to the condominium
7 and the residents, and that should be no surprise.

8 As a matter of fact, BellSouth's pleadings are dauted
9 with examples of that distinction and we freely grant that the
10 Commission typically has no power to exercise what are properly
11 judicial functions awarding damages as in Southern Bell, Mobile
12 America; or the Deltona case, you may be familiar with that
13 case. In the Deltona case, again, cited by BellSouth, the
14 Commission was of the view that Deltona had improperly included
15 what should have been contributions in aid of construction in
16 the calculation rate base, and they attempted to make a rate
17 base adjustment.

18 The problem was based on the court's opinion, there
19 was insufficient evidence in the record to support that. And
20 the Court said since the audit turned up nothing like that,
21 we're not going to let you, the Commission, take action which
22 is, in essence, an attempt to adjudicate some sort of land
23 fraud theory which belongs in circuit court by making a
24 ratemaking adjustment.

25 So, in the Deltona case, in the Southern Bell Mobile

1 America case, and in the Teleco case, BellSouth can point you
2 to instances in which the court has said, sorry, you can't do
3 that. You can't award damages. You cannot perform the role
4 that is reserved for the circuit courts, but nothing in its
5 decision in the Teleco case gives BellSouth any comfort with
6 respect to what is necessarily implied for the regulation of
7 telecommunications.

8 In its pleadings, BellSouth describes the remedy
9 that's been proposed here as Draconian. Well, I submit to you
10 whether a remedy is Draconian or appropriate depends upon the
11 exigencies of the circumstances. Now, AT&T asserts and the FCC
12 asserts that we have a severe problem here and that dramatic
13 measures are called for. We don't suggest that this structural
14 remedy is something that you take lightly, but we do suggest
15 that other efforts have been unsuccessful and that given the
16 impetus of both the federal law and the state law towards
17 forming effective competition in the local exchange market and
18 given the lack of success of other measures, we believe that
19 the structural remedy is not only appropriate, it's necessary
20 and the choice of words is deliberate, because the extent of
21 your powers is that which is necessarily implied by law.

22 Thank you.

23 COMMISSIONER JABER: Mr. McGlothlin, let me ask you
24 the question I asked earlier with respect to Mr. Lackey's
25 argument that in exercising our jurisdiction, assuming we have

1 it, to require BellSouth to separate completely, it would
2 result in a wholesale company being nonjurisdictional,
3 according to the definition of telecommunications company. Do
4 you agree with that? If not, why not?

5 MR. McGLOTHLIN: I can't give you a definitive yes or
6 no on whether the definition comes into play. As AT&T's
7 attorneys also observe, this is new today, as far as I can
8 tell, but in the bigger picture, whether that's right or wrong,
9 I believe, is secondary to this observation. Whether you're
10 dealing with BellSouth as it presently exists or whether you're
11 dealing with separate wholesale and retail entities, the
12 totality of your functions doesn't change.

13 Presently, you get into such things as approval of
14 interconnection agreements and the arbitration of disputes
15 because Congress gave you that role in the federal Act. And if
16 we have separate wholesale and retail entities, your functions
17 under the federal Act don't change and your functions, in terms
18 of the quality of service in regulating the service given to
19 the end user don't change, so I see this existing one package
20 being two packages but that the combination of your functions
21 in total is not effective.

22 COMMISSIONER JABER: Confirm for me, though, you want
23 -- in terms of what you're asking for and what AT&T has asked
24 for, you do want a full separation, a creation of two companies
25 or a division of the company into two separate divisions,

1 retail and wholesale. That is the remedy in its essence, as I
2 understand it.

3 MR. McGLOTHLIN: Let me just point out, though, that
4 what FCC asks for in its separate request was an investigation
5 of structural remedies.

6 COMMISSIONER JABER: Okay.

7 MR. McGLOTHLIN: And so, I don't think FCC has taken
8 a position that only -- that can only take one form. I do
9 think that something may be fashioned to meet the needs of the
10 situation. Thank you.

11 CHAIRMAN JACOBS: Thank you.

12 MR. GILLAN: Can you hear me?

13 CHAIRMAN JACOBS: I think so.

14 MR. GILLAN: Do you want to hear me? This is a
15 dangerous question.

16 CHAIRMAN JACOBS: Always...

17 MR. GILLAN: Good afternoon and thank you for your
18 patience. I have a lot of material to cover, but I'll try to
19 keep it moving along, but if you have any questions please
20 interrupt me. That will probably be the easiest way to do
21 this. My name is Joe Gillan. I am here appearing on behalf of
22 the Florida Competitive Carriers Association following in our
23 tradition of only hiring people with the name Joe.

24 I think, it's important to emphasize that I'm here on
25 behalf of the Florida Competitive Carriers Association, because

1 an awful lot of what you heard this morning was BellSouth says,
2 AT&T says, and this is really far beyond a dispute between
3 BellSouth and AT&T. As Mr. McGlothlin mentioned, the Florida
4 Competitive Carriers Association filed a supporting document
5 really asking you to investigate this issue. And the reason
6 for that, as I'll go through, is that my presentation, to give
7 you a map of it, is to look a little bit at the status of local
8 competition today, in Florida, specifically, more generally
9 around the country.

10 We think this is broken. We think there are some
11 very serious and clear implications as to where this is going
12 to head given its status today. And by and large, we see the
13 world basically shaping up with two different paths for you.
14 You can either attempt to continue to make local competition
15 happen through a series of police actions, continuing to have
16 dockets on cost studies, continuing to have dockets defining
17 disputes between both supplier, BellSouth, and these
18 purchasers, those CLECs, and continuing to have enforcement
19 procedures and performance measures and tests and everything
20 else under the sun or you can look -- step back a little bit
21 and say is there a way to turn this in on itself to where the
22 incentives start to line up where these parties have an
23 incentive to solve more of these problems before they bring
24 them to you?

25 And it seems to me, quite frankly, one of the ways I

1 look at this, about a decade ago, this Commission, other
2 Commissions, spent a lot of time looking at price cap
3 regulation, because you were looking to find ways to take
4 natural commercial incentives and overlay them on top of
5 regulation to get to your policy result.

6 And what we're really talking about with you today
7 is, is there a way for you to look at other things, in effect,
8 BellSouth's corporate structure, to come up with an incentive
9 strategy for the wholesale market in the same way -- or not the
10 same way, but in an analogous way that price caps were adopted
11 as a way to give incentive regulation for the retail
12 operations?

13 Finally, I'm going to present some elements of one
14 way of doing a structural approach. And, I think, it'll answer
15 some of the Commissioners questions as to what type of relief
16 are you asking for, because clearly the reality is right now
17 we're asking you to have a docket to look at these alternatives
18 and learn about them and become educated about them, because
19 this is not a simple question. We recognize that BellSouth
20 recognizes it, but the reality is we also feel if we don't find
21 some better way of doing this, this whole competitive
22 experiment is in its twilight.

23 As twilights go, this one never got very far.
24 Current statistics. And everyone has a little bit different
25 measure of competitive success in Florida, but I would suggest

1 that even BellSouth's high estimate should be considered a
2 failure if you moderate it at all to look at numbers that Staff
3 has collected or the association itself has presented. Five
4 years into this experiment we have trivial market share.

5 CHAIRMAN JACOBS: Is this total business and res?

6 MR. GILLAN: Total bus and res. Now, why the
7 difference between those numbers? Particularly, focusing on
8 the difference between what the association sees and what
9 BellSouth has presented, well, there's really kind of three.
10 And just to identify them for you, we consider all BellSouth
11 lines in our analysis, including what are called special access
12 lines, because that's a form of local capacity. We use some
13 more current data than BellSouth is using, but mostly the
14 difference can be explained, because we will acknowledge that
15 the CLECs have been successful in serving one small customer
16 segment, the ISP community.

17 And to our mind, the goal here really is to get broad
18 competition to residential and small business customers, and
19 that's where this thing needs to go. Once you make that
20 adjustment, and you can see it in this slide, basically, the
21 C-- whoops, this is looking at local traffic. BellSouth has
22 95% of the market, the CLECs have roughly 5%, but that is, even
23 today, heavily involved in serving the ISP community. That's
24 not where we want to be. That's not where we need to be, but
25 that's really all that's developed so far.

1 Yes, Commissioner or Chairman.

2 CHAIRMAN JACOBS: You'll probably get to this. If
3 you do, just say so, but you recognize that the response to
4 that is that the isolation on ISPs is by design, not by market
5 failure.

6 MR. GILLAN: Well, I think, what -- they way I would
7 respond to it, I don't get to it specifically. I represent an
8 awful lot of companies and have worked with companies since the
9 '94, '95 time frame when it was clear to me that some sort of
10 local competition had to develop or everything else was going
11 to crash and that focus has been, for the past six years,
12 trying to find ways to get carriers in to serve small
13 businesses, residential customers, because the reality --
14 everyone sits here and they talk about, well, the CLECs just go
15 to the big business and they go to the ISPs.

16 Well, there's a reason why you see so much activity
17 there. These are the only things that people could do, but it
18 isn't what people were trying to do. The floor is littered
19 with the bodies of companies that have been trying to serve
20 residential customers, been trying to serve small business
21 customers, they ended up on that end of the market for a
22 variety of reasons. I'm not going to come here and tell you
23 that, you know, all the problems of the CLECs are the ILECs'
24 fault. Candidly they're not. But the other part of this is
25 I'm not sure how relevant that is anymore, because one part of

1 it was the ILECs' fault and that is getting people to be in a
2 position to serve that vast majority of customers out there
3 that use analog phone service.

4 And until that nut is cracked, because that's where a
5 heck of a lot of the money is in this business, and until
6 people can compete for residential and small business, if all
7 you can do is sort of play around the edge of this thing, as
8 soon as the ILEC has that market locked down and they know that
9 one's in their pocket, they can walk around the dial and just
10 pick off the rest of these companies. We want to be in that
11 market. It isn't for a lack of trying.

12 Where are we? Well, we are in crisis, and we gave a
13 presentation to you a couple of weeks ago that financial
14 collapse is sectorwide. It isn't that we picked out a few that
15 had a bad business plan or bad luck or bad timing or even bad
16 karma, this is a sectorwide collapse of this industry, and what
17 it means is that you can't get company, all right? The CLEC
18 community can't get money. So, as a practical matter, either
19 you've got enough to survive or you don't. And when you look
20 out at those companies, you've got to look long and hard to
21 find anyone who has enough money to survive.

22 Now, I am sure tomorrow you will hear the chant that,
23 well, there's this company that has that and that company that
24 has this and, quite frankly, I could get up and perhaps will,
25 if I'm fortunate, be able to still get up immediately after

1 that presentation and address the specifics of each one of
2 those individual companies, but they've all got one thing in
3 common, they're all going to run out of cash, unless something
4 dramatic happens, and even then, the real question here is are
5 you satisfied with this level of competition?

6 If one or two of these CLECs survives serving just
7 one or two customers in isolated markets, is that what you
8 want? That's not what the Act was about and that's not what, I
9 think, you need to achieve.

10 Now, as I said, I'm really not here to cast blame,
11 because, I think, the more important point is where do you go
12 from here recognizing the shape this industry is in? Because
13 the number one implication, in my mind, of the current status
14 of CLEC competition is the resources that you need to litigate
15 your way into this market, they're not there anymore.

16 After five years, those bullets are all shot. And
17 so, the question either is the industry is going have to rely
18 on public resources, the Staffs of Commissions or wherever
19 they're going to come from to do the next round of cost cases
20 and figure out the next round of debate or we have to find a
21 more cost-effective solution.

22 Maybe that's good news, because nobody's enjoyed any
23 of these cost cases anyway, but the reality is we have to find
24 something that's more efficient, both in terms of the results
25 it gets and then the resources it consumes. The implication,

1 if you do nothing, well, again, I don't think you need to be a
2 rocket scientist to set back and look at this and figure out,
3 all right, if the CLECs fail and this thing continues the way
4 it's headed and we're at -- you know, we're reaching a zenith
5 at 5, 6, maybe Bell's number, 10%, what's going to happen next?

6 The reality here is that local service is a mandatory
7 element of any kind of communications package. If you can't
8 sell local, you can't sell the other stuff. That means that
9 once all the local telephone companies have added these other
10 products to their package with local, unless other people are
11 also able to offer those packages, things are going to get even
12 worse. These companies are going to vertically integrate out
13 into long distance, into Internet crowding out the other forms
14 of competition. You will see, over a period of time, more
15 mergers as the people that are in those lines of business
16 today, the quote, long-distance companies surrender and merge
17 into parts of these local companies, SBC or Verizon, maybe even
18 BellSouth.

19 The result is 20 years after divestiture we've gone
20 full circle and we're back to a fully-integrated local company
21 serving different regions of the country again. And that just
22 doesn't make sense. Not only do I think you'll see it in terms
23 of your direct regulation, but then there's going to be
24 additional sort of follow-on implications to that concentrated
25 market. Innovation will slow, because people have a better

1 idea, will have a very limited opportunity to bring it to
2 marketplace. If you come up with a new application, you have
3 to -- you'll first be forced to go down and to talk the two or
4 three companies remaining that actually have customer bases as
5 a way of marketing it. You don't want to create that kind of
6 environment.

7 I mean, you kind of have that in the computer world
8 today where you have to make your products conform to
9 Microsoft. You don't want to do that in the communications
10 marketplace, but you will begin to see that, and you're
11 beginning to see the second point already. Vendors will
12 ultimately say these other guys are not going to succeed, I'm
13 going to design my product, I'm going to design my sales, I'm
14 going to provide all my customer support for only the large
15 suppliers. If an ILEC doesn't want to buy it, I don't want to
16 build it. And over time, you'll see prices change as well.

17 Yes, Mr. Chairman.

18 CHAIRMAN JACOBS: One of the interesting areas --
19 because I kind of followed that logic, but it doesn't seem to
20 hold, unfortunately, because what I've seen happening is
21 service quality. You would think that, then, big players would
22 be seeing the very best service quality out there because
23 that's where, arguably, the most competition is, but it seems
24 that the degradation in service quality extends even to
25 business customers. Is that your experience?

1 MR. GILLAN: Well, yes. I think, the degradation in
2 service quality is extending to business customers, but I don't
3 use the word business customer as though it's a homogenous
4 group, and I think that's the biggest mistake that everyone is
5 falling into a pattern saying there is no residential
6 competition, but there is business competition. That statement
7 isn't true.

8 Most businesses or small businesses, three lines,
9 five lines, eight lines, they have regular phone service, maybe
10 they have one high-speed digital connection. Those guys aren't
11 in any better shape really than residential customers. That's
12 why, I think, you're starting to see the service quality
13 issues, at least in the places I followed them more closely
14 which, quite frankly, has been more in the midwest than here.

15 Large businesses, there are reasons why you see
16 competition up at that end of the spectrum that have less to do
17 with price and a lot more to do with those customers are more
18 used to having their services handcrafted to them, they sign
19 long-term contracts, they're very -- they're boutique to serve,
20 and in that marketplace you do see some smaller players having
21 some success, but when people say that there's business
22 competition, I think, they really do a disservice for all the
23 small businesses that really are in the same boat as basic
24 residential.

25 If you had got an analog phone and you're an analog

1 customer, you don't have much choice in this country today,
2 with the exception of places where network elements
3 combinations have been made more freely available, which I
4 think I just did the segue to this slide, which is where this
5 failure is going to be felt the most and first is in that core
6 market of residential and small business customers, because
7 that's where you're most dependent on using the existing
8 network to provide service, that's we're you're most
9 susceptible to produce discrimination. And I would submit
10 that's where public policy should be the most concerned about
11 seeing some competitive gains.

12 Bottom line, entry means that we need, the CLEC
13 community needs the ability to use that inheritive exchange
14 network. That's a large market. That's where we need to go,
15 that's where policy needs us to go, and the RBOCs understand --
16 the ILECs understand that dependency, and they're not going to
17 be a willing supplier.

18 Now, I know they're going to come up here, we comply
19 with this, we comply with that. And you know what, even though
20 that's true, part of the problem here is if the only thing you
21 get from your supplier is compliance, as opposed to a
22 willingness to sell you things, we're going to be here forever,
23 because we need them not interested in passing a performance
24 plan, we need them interested in finding a good solution to the
25 problems that crop up in this. We need their imagination,

1 their creativity. We need them to want this to work, not want
2 this to just look like it's working, according to some
3 performance measure.

4 Standardized testing isn't going to solve this for
5 us. We need true desire. And how do we get that desire?
6 Well, in our view, the fundamental problem is that we're on the
7 outside competing against the closed system, that as long as
8 the ILEC has wholesale and retail operations integrated and all
9 they're trying to do is, quote, comply with the notion that
10 they're going to sell things to us under systems that are
11 separate but, quote, allegedly equal, we're not going to get
12 anywhere. We're just going to always be in front of you
13 fighting battle after battle.

14 The consequences can be felt in two major areas:
15 One, the question of OSS. How do you measure -- how can you
16 have systems that aren't the same but then try to act as though
17 they are operating the same? Now, you can do it the way we're
18 doing it so far, performance test after performance test,
19 metrics after metrics, applied standardized testing, but all
20 you're going to do is get arguments about test scores, it's not
21 going to change in the marketplace.

22 Secondly, you've got to do cost modeling, maybe
23 perfectly, but certainly really right, because that CLEC needs
24 to be paying a rate for the use of that network that is what
25 the company thinks is its true underlying cost. And getting

1 that right, in the best of circumstances, may be an impossible
2 task.

3 COMMISSIONER JABER: Mr. Gillan?

4 MR. GILLAN: Yes.

5 COMMISSIONER JABER: Just as a matter of logistics,
6 if we agreed that we had jurisdiction to separate the company
7 and the wholesale side was providing elements to the CLEC
8 industry at cost, how does the wholesale side stay viable? Do
9 we -- is that something we have to incorporate in the
10 structural plan as well?

11 MR. GILLAN: I think, you have to recognize that that
12 entity is going to have to charge for running its network rates
13 that compensate it fully on a forward-looking basis, but at any
14 rate, you're going to be stuck with that either in terms of
15 trying to make -- but you're in different measures, I guess, is
16 the short answer. If they're truly sitting out there as a
17 network company, you will be able to start falling back on some
18 accounting measures as to, hey, is this covering the company's
19 cost. You also, however, and I think this is the most
20 important, whatever the consequence is of the price levels that
21 it sets, it's going to be felt equally in the retail
22 marketplace by all the CLECs and not just, you know, including
23 the one that it's affiliated with. And I'll show you in a few
24 later slides how we would -- one way you could go through
25 implementing this.

1 COMMISSIONER JABER: Okay. So, the new prices, then,
2 would have to incorporate the cost of doing business as a
3 separate company.

4 MR. GILLAN: Yes, but you know as a practical matter,
5 that's what these Telric studies are supposed to be estimating
6 anyway. You're supposed to be trying to estimate what is the
7 cost of a network element company, including providing that
8 company's the recovery of the common cost incurred by a company
9 that's only in the network business and providing it a return
10 on capital to those network-related costs. So I don't think in
11 that sense the goal changes any.

12 The goal, from our perspective, is that you want
13 arms-length transactions, you want the OSS to be the same so
14 that you have parity by design, not parity by performance
15 measure, and you want the same cost basis for the common
16 network. The problem you then have to solve is, all right, how
17 do we achieve independent behavior between these retail
18 operations and this wholesale operation so that you do get this
19 operational transparency of they're using the same OSS, and you
20 get some economic transparency that the retail entity is
21 actually responding to those wholesale prices as a competitive
22 firm would be.

23 As long as it's in this kind of mode of operation,
24 that's going to be very difficult to achieve, because you're
25 really going to be in a -- I guess, the word you have been

1 using this morning, functional separation, you're still going
2 to be sort of trying to solve the same problem. You're going
3 to be trying these rules to make one company, this holding
4 company, act as though it's two companies. And, I think, one
5 of the messages I want to leave with you is that as long as
6 you're trying get these companies to pretend they're not the
7 same, you're going to run into difficulty.

8 On one end of this spectrum of things that you can do
9 for incentives is this sort of functional separation or what I
10 would call accounting base separation where the two entities
11 are still owned by -- they're still jointly owned by one
12 entity, they're still really one company at the point that it
13 matters, which is the point which you report this is how much
14 money we made and the stockholders reward you for either doing
15 a good job or a bad job. As long as you've got only one stock
16 being traded for these things and there's only one place in
17 which the market says good boy, bad boy, there's just no way I
18 believe that through rules alone you're going to get them to
19 act in an independent manner.

20 If you did this, you'd have go through additional and
21 extensive code of conduct to try to force them to behave as
22 though the retail arm was actually paying the wholesale arm
23 those network element prices, which then means you would have
24 to have some sort of imputation rule that allowed you to judge
25 whether the retail arm was actually reflecting those costs in

1 its prices, and you'd have this continued police action.

2 There's actually another consequence that I didn't
3 put up there, but I think this is equally important to realize
4 as we go through this docket and look at these alternatives.
5 In this kind of operation, that retail arm would forever be
6 considered an incumbent local exchange carrier and would still
7 have the Section 251 obligations that go with being an
8 incumbent local exchange carrier, because it still is the same
9 entity, the holding company.

10 At the other end of the spectrum is the pure solution
11 of complete divestiture. You split the company between a
12 wholesale and retail instantly. You spin off ownership to an
13 independent class of stockholders. There is no continuing
14 relationship between the holding company and the wholesale
15 company.

16 There is, however, in our view, a middle ground
17 between these two that needs to be seriously considered. That
18 middle ground would be that the retail entity issue a
19 publicly-traded stock. It would still be majority held by the
20 holding company, so it would still be an affiliate and
21 BellSouth would still be majority owner of it, but that by
22 issuing to its shareholders initially a distinct class of
23 stock, then those stockholders could trade that and there would
24 be a market valuation.

25 And the advantage of this type of structure is that

1 for the first time here the managers of that retail arm would
2 have to report back to stockholders different than BellSouth
3 stockholders and make money, offer products, win customers and
4 compete and report to them here are the results of my operation
5 as a distinct company. That is how you create a clear
6 independent management team, particularly, if one of the
7 requirements in the code of conduct is that the retail entity's
8 management options and bonuses are tied to the performance of
9 that retail stock.

10 That, more than anything, will cause their incentives
11 to operate as an independent entity. The failure of the
12 Telecom Act isn't -- if anything, may be traced to the fact
13 that we don't read enough Shakespeare. It's human nature.
14 Until they have their own independent objective function to go
15 out and maximize, they have their own fate in their hands,
16 they're going to be acting to maximize the value of BellSouth.

17 The advantages of this type of an approach is that it
18 would promote economic transparency between the affiliates. In
19 other words, if you have accounting-based separation and you
20 separate them into some sort of functional entities, you might
21 get to the point where the retail entity uses the same OSS as
22 other CLECs. That would give you some benefit, because then at
23 least some of the OSS issues would be resolved, but you would
24 not have any way to have them react to the input prices like
25 any other CLEC would as a real cash outlay that they're paying

1 to somebody else, because they'd all still be part of the same
2 company. When you have this partial public ownership, though,
3 you create some distinct ownership interest and, therefore, you
4 get them reacting as an independent entity for pricing purposes
5 as well as operational purposes.

6 Our hope, our view, is that that kind of structure,
7 once implemented, requires far less regulatory oversight on a
8 going-forward basis than the current system. In effect you
9 trade one large regulatory decision to create an incentive
10 structure that makes other decisions less critical. Now,
11 again, there are different ways to skin this cat and to gain
12 different featured benefits and incur different costs. Here's
13 one implementation sequence that we're looking at seriously
14 that addresses a lot of the points that have been raised.

15 First, we begin recognizing that today there's a
16 wholesale and legacy retail operation that's currently housed
17 in BellSouth. They've done some work to have the wholesale
18 entity offer services to the other providers, but as of today
19 their legacy retail operations remain integrated.

20 What we have proposed for them to do is to first
21 establish a retail CLEC, like other companies. Now, that
22 company would have a couple of things that would have to be
23 done. First, we would have BellSouth initially issue to its
24 stockholders enough separately-tradable shares that over time
25 as stockholders make different decisions over which stock to

1 invest in, the one that today represents BellSouth or the more
2 risky venture of in the CLEC directly that you could get some
3 market valuation of that company.

4 Secondly, that retail company -- over time, of
5 course, those shareholders become distinct groups. That retail
6 CLEC -- and this is actually the only new thing that would need
7 to be created is that that retail CLEC wouldn't have customers
8 and it wouldn't have the customer care capability, because
9 they'd have to create systems like any other CLEC that
10 interface into the wholesale systems for ordering network
11 elements, obtaining network elements, billing, provisioning, et
12 cetera, because the legacy integrated systems would continue
13 with the holding company.

14 To effect the transition to the new structure, we
15 propose a set of simple rules or at least one way of doing this
16 would be the holding company, BellSouth, would not be permitted
17 to add new customers. It would support the inheritive base of
18 customers using the same set of services, tariffs, prices that
19 they have today, and then it would offer UNEs to other CLECs.

20 On the other hand, the retail CLEC, that's where
21 BellSouth would introduce its new services. So, to win new
22 customers, to offer new services, they would do it through a
23 retail CLEC that would be much -- well, it would be, for all
24 practical purposes, like any other CLEC in the marketplace and
25 including, I think we could talk as to whether this degree of

1 separation would be sufficient to excuse that CLEC from Section
2 251 obligation, so it wouldn't be considered an ILEC, it would
3 be considered one of us. It would offer new services, it would
4 seek to win new customers, both customers that move into the
5 area and just as importantly it, like everybody else, would try
6 to win customers from the legacy base of BellSouth. In short,
7 it would compete like the rest of us.

8 Over time, in this kind of structure, what we would
9 expect is that the customers overall, over time start signing
10 up with CLECs, including BellSouth CLECs, so that the legacy
11 retail operation shrinks. And the holding company or
12 BellSouth's existing operation over time becomes just a
13 wholesale company, but it would take a period of time while the
14 market adjusts to this new reality of multiple CLECs, new
15 service offerings, customers moving into the area.

16 This way BellSouth would continue to use its legacy
17 systems until the legacy base was gone and the only thing new
18 would be the creation of this retail CLEC with what would have
19 to be new systems, because for the first time they would have
20 to live with the OSS that they've created for us, and that's an
21 important feature of the plan, because we want them to live
22 with the OSS systems that they created for the CLECs, because
23 we believe that's the only time that they will sit down and
24 say, what is the best way to sell these network elements to
25 people? What is the best way to provision this network to

1 competitors?

2 COMMISSIONER JABER: Mr. Gillan, I --

3 MR. GILLAN: Yes.

4 COMMISSIONER JABER: I guess, I don't see the
5 independence as long as there's a line between the holding
6 company and the retail CLEC. I don't -- I fail to see your
7 point with respect to independence, as long -- the
8 stockholders, if they don't receive a return from the retail
9 CLEC, won't the stockholders, the line from holding company to
10 stockholders, have to answer to that?

11 MR. GILLAN: Well, the retail CLEC would have to
12 manage its business for its stock to have value. BellSouth's
13 overall stock would have value, both for its wholesale
14 operations and its percentage of ownership in the retail CLEC,
15 but the stock value itself would be defined as the 40% of the
16 stock that is publicly traded is traded in the marketplace.

17 That's where the market will tell the retail
18 management and derivatively the BellSouth management, hey, this
19 company is a viable, sound competitor and force that retail
20 management to operate as efficiently as possible, because if it
21 can't make -- in the other formulation where it's 100% owned by
22 the holding company, the stock market never sees and,
23 therefore, never has a chance to say these are good prices,
24 these are good policies, these are good products you're
25 offering, because it all gets rolled up into a single income

1 statement that's reported for the holding company overall.

2 This gives you a chance to have some instrument out
3 there that allows the market to value that company. And then
4 by that value, that will partially drive BellSouth's stock
5 value, but those retail managers will be forced to run a
6 company to earn a profit, like the rest of us.

7 COMMISSIONER DEASON: Let me ask the question. Under
8 your proposal, the legacy retail would be prevented from
9 signing or obtaining new customers, correct?

10 MR. GILLAN: Correct.

11 COMMISSIONER DEASON: So -- and the retail CLEC would
12 have the ability and the incentive to sign new customers --
13 actually, new customers or to win away customers from legacy
14 retail, correct?

15 MR. GILLAN: Correct, like the rest of us.

16 COMMISSIONER DEASON: Okay. Now, let me ask you
17 this: What's to prevent the retail CLEC management from
18 offering a really great deal, giving the majority of the legacy
19 retail customers, and since they're a retail CLEC, then raise
20 prices 100% and the customers have no choice because the legacy
21 retail cannot get any new customer? So, once a legacy customer
22 transfers over to retail CLEC, they can't go back to legacy.

23 MR. GILLAN: That's right.

24 COMMISSIONER DEASON: And that gives the retail CLEC
25 all the pricing flexibility that they want and perhaps need.

1 I'm not making any judgment on that.

2 MR. GILLAN: The goal is --

3 COMMISSIONER DEASON: What's to prevent them from
4 increasing prices once they make a big enough inroad into the
5 legacy retail market share?

6 MR. GILLAN: The existence of -- the entire intent of
7 this is for there to be existence of multiple CLECs on the
8 right-hand side here, other retail CLECs, none -- the others of
9 which would all be independent of BellSouth offering services
10 and competing for those customers so that at the end of the day
11 what prevents that competitive CLEC from raising its prices is
12 the existence of other competitive local exchange carriers.

13 COMMISSIONER DEASON: So, are you predicting that
14 prices would not go up from the current level?

15 MR. GILLAN: In the current situation, I would not --
16 depends on where the network element prices go, quite frankly.
17 I mean, Commissioner, I believe that there's a problem with the
18 level of network element prices in this state, a situation that
19 BellSouth would have an incentive to correct under this system;
20 in part, because it knows it will have to create network
21 element prices that its own retail network operation would have
22 to live with as well. It's not a wholly-owned retail
23 operation, but it would have to live with them as well.

24 COMMISSIONER DEASON: Now, if we're going to have two
25 separate operating divisions, each with their incentives to

1 maximize their profit, where is the incentive for the wholesale
2 side to reduce their prices? They're still the monopoly
3 provider.

4 MR. GILLAN: I recognize that.

5 COMMISSIONER DEASON: When and does a monopoly ever
6 have an incentive to reduce its prices?

7 MR. GILLAN: The only consequence they will face on
8 this is they will have their own retail affiliate telling them,
9 hey, I can't compete profitably with this either, so there will
10 be one more voice in your hearing room. Initially, I believe,
11 that the reality is those wholesale prices are going to
12 continue to have to be set by this Commission, but at least
13 under this type of an arrangement you'll start to see retail
14 competition on that wholesale base so that over time, the much
15 longer period of time it's going to take for other
16 facilities-based networks to get out there so that you don't
17 need to engage in wholesale regulation as well. But, I think,
18 right now there's no question, even under any of these
19 proposals you're still going to have wholesale regulation to
20 address.

21 I think, it'll become simpler -- I mean, some of the
22 things that you've been asked to decide on -- for instance, we
23 won't combine network elements. That's the position of the
24 ILECs. Well, no rational wholesale company in their right mind
25 would even come to you with that issue, because it's -- you

1 don't try to make it as difficult as possible for people to use
2 your network. If BellSouth's own retail CLEC was out there
3 having to actually go through the processes that BellSouth
4 created for the rest of us, it would take no time at all for
5 them to come back and say, look, we can't do anything with this
6 kind of product the way you've arranged it so, I think, some of
7 the solutions will become simpler.

8 It's not perfect, because I can't create perfection
9 for you. What it is, is a way to try and put forth a proposal
10 that will fundamentally change as many of these incentives as
11 we can to avoid what, I think, is going to be a really far,
12 far, far less perfect outcome, which is this whole experiment
13 failing and the monopoly having control.

14 COMMISSIONER PALECKI: I'm not sure why the legacy
15 retail customers would be left on the wholesale side. It
16 almost seems to me that it would motivate the holding company
17 even more to protect those customers from going to any of the
18 CLEC community that they would continue to reap the same
19 profits that they normally do as long as none of the legacy
20 retail customers are lost to the competition.

21 MR. GILLAN: There are two reasons why I think this
22 makes more sense than -- well, there are two reasons why this
23 was designed this way: One is you've got to do something with
24 the fact that BellSouth is a starting monopoly, so if you don't
25 -- this structure, what it permits BellSouth to do is enter as

1 a CLEC at relatively low volumes and grow at a more natural
2 market pace. And then at the same time, it means that that
3 retail CLEC that BellSouth has created has to use the exact
4 same OSS that we use; and then, thirdly, it means that that
5 retail CLEC has to work to win customers in the same way that
6 the rest of us have to work to win them.

7 Now, there's nothing else I can do with this customer
8 base that I've been able to come across from this perspective,
9 other than transfer all those customers over to the BellSouth
10 CLEC so that on day one it starts with the entire customer base
11 either weaving in the legacy thing and have people win them
12 over time or you put them in the BellSouth retail company.

13 If you put them in the BellSouth retail company, then
14 I have a whole other issue, I think, to come up with that are
15 cleaner answers to than the ones here. First, now, I've got a
16 BellSouth retail CLEC that's a monopoly in the same way that
17 the existing one is, so then I've got to regulate it
18 differently than the other CLECs. One of the advantages of
19 this is that it allows, since BellSouth's CLEC operation
20 doesn't start any larger or any differently than anybody else,
21 it can be regulated more comparably to everyone else.

22 COMMISSIONER PALECKI: Well, what if --

23 MR. GILLAN: Second--

24 COMMISSIONER PALECKI: Just --

25 MR. GILLAN: Okay.

1 COMMISSIONER PALECKI: What if they're not
2 successful, BellSouth's CLEC operation? Don't we just have the
3 status quo being maintained?

4 MR. GILLAN: No, there's two things. First, the mere
5 fact that the wholesale legacy operation can't add customers
6 means that roughly 15% of the market changes every year, so you
7 know that there's a portion of the marketplace that's going to
8 go into competitive play every year no matter what. That means
9 that BellSouth's legacy operation has to learn how to compete
10 and has to learn how to win customers or see their customer
11 base atrophy at a relatively rapid rate.

12 So, there is no static answer for them under this
13 proposal, because that part of the proposal that they can't add
14 to the existing base is going to put a pretty significant
15 portion of the customers in play on a natural basis each and
16 every year as customers come and go, particularly, here in
17 Florida.

18 The other two reasons why I don't think you want to
19 adopt a system where you transfer those customers into the
20 retail CLEC are, secondly, they would all end up over there
21 without ever having to go through the OSS systems of ordering
22 those network elements.

23 Well, one of the reasons we're doing this is so that
24 those OSS systems get perfected and improved and BellSouth
25 would get all of its customers through this inheritive transfer

1 instead of through winning them and migrating them through that
2 OSS. And the third reason, quite frankly, is that if you try
3 to start a CLEC with, I think, they have 10 million access
4 lines, they're going to run into problems, because creating a
5 company with 10 millions lines instantly is going to have a
6 failure associated with it, so this puts them in the position
7 like other CLECs of that you start small and you grow and that
8 you allow time to give them a much more natural adjustment
9 process. Those were the three basic reasons why this proposal,
10 at least, ended up looking at the legacy base with the holding
11 company for a period of time so that time becomes your ally.

12 Now, quite frankly, Commissioner, this whole
13 discussion is exactly the type of thing that you need this
14 docket to learn more about, because there's no way for me to
15 explain all the reasons why. This is sort of where my thinking
16 is right now in the time that I've already used.

17 COMMISSIONER JABER: Mr. Gillan, the retail CLEC, at
18 least initially, will have the financial backing of the holding
19 company.

20 MR. GILLAN: Correct.

21 COMMISSIONER JABER: So, then, it's not in the
22 position of every other CLEC.

23 MR. GILLAN: Is not the same as a completed
24 divestiture, but it is a way for BellSouth -- in my mind, it's
25 a way for BellSouth to operate as a CLEC as closely as we can

1 humanly make it, while at the same time have them beat
2 BellSouth.

3 COMMISSIONER JABER: But wouldn't we also, then, have
4 to consider another code of conduct between the retail CLEC and
5 the holding company or the retail CLEC and the wholesale
6 company? I mean, it seems to me, to the degree there's
7 anticompetitive behavior, this just shifts it.

8 MR. GILLAN: I think -- well, let me answer your
9 question. I think, there's two questions in there. The first
10 is will you need a code of conduct? Yes. I think, as a
11 practical matter what you have is the number of rules in the
12 code of conduct and the problems they address are inversely
13 related to the degree of separation.

14 If you have functional separation, I think, what
15 they're going to discover in Pennsylvania, since they're going
16 to try and pretend that one company is two companies and come
17 up with all the rules that make it work that way, you end up
18 with a very big code of conduct. If you go with complete
19 divestiture, and you have no -- you know, it's total and pure
20 separation, then you need maybe no code of conduct. This is
21 between those two extremes. Will you still need a code of
22 conduct for some things? Yes.

23 Do I believe, however, that the fact that that
24 company has an independent ownership in stock price and profit
25 maximizing goal of its own and that BellSouth only owns 60% of

1 it that that code of conduct will be simpler and easier and
2 more self-enforcing? Yes. It's in there between the perfectly
3 evil and the perfectly good. Or maybe I should say the
4 perfectly worthless.

5 And I probably shouldn't even say perfectly
6 worthless, because the reality is a functional separation, if
7 you get them to the point where they have to use the exact same
8 OSS, at least gives you that. It gives you they're living with
9 the OSS that everyone else lives with. But it seems to me that
10 if you're going down this path of really looking at how to
11 create some new incentives here so that we get wholesale
12 operations that operate independently, we should consider other
13 options as well.

14 COMMISSIONER DEASON: Let me ask you this; maybe you
15 haven't thought of it, and maybe you have. The retail CLEC,
16 how would they market their services? Would it be -- would
17 they use the BellSouth name or would they be required to come
18 up with a totally different name that which would not provide
19 any indication to customers that they're affiliated with
20 BellSouth?

21 MR. GILLAN: In my own view, the retail -- one of the
22 code of conducts should be that the retail CLEC should not use
23 the BellSouth names so that its marketplace presence it's
24 distinct from the legacy company. Is that a judgment call?
25 Absolutely. I think that it would be useful to have them use a

1 new name. They certainly don't let anyone else use the
2 BellSouth name. I think, Rodney Page will tell you that even
3 when he buys service from them, he's not allowed to tell people
4 that that's where he gets his network. So, I think that, in my
5 own view, I think, you'd get a cleaner separation if they used
6 a new corporate name. It's a little bit more complicated in
7 the BellSouth region, because BellSouth hasn't yet adopted a
8 new corporate name; whereas, outside of this region all the
9 ILECS have already gotten rid of their old corporate names, and
10 so the branding issue isn't quite as large.

11 COMMISSIONER DEASON: So, under this proposal and
12 maybe this would be a small minority of the cases but, for
13 example, if there were a customer of BellSouth who had been a
14 customer for 30 years and he or she decides to sell their house
15 and move across town and they want to become a BellSouth
16 customer again they wouldn't be able to, they'd have to --

17 MR. GILLAN: They'd have to go out among the CLECs of
18 which one of them will be this BellSouth retail segment.

19 COMMISSIONER DEASON: But they wouldn't know that. I
20 mean, I'm just trying to envision -- you know, from the
21 practical side, people would be out there saying, "I've been a
22 customer for BellSouth for 30 years, you people in Tallahassee
23 think you know it all, I was happy with BellSouth, and now you
24 tell me I cannot continue to be a customer of BellSouth? I
25 mean, that's the type of real-world situations we would be

1 faced with.

2 MR. GILLAN: I understand that, Commissioner. And as
3 I indicated, it's a judgment call, but this -- consumers are
4 going to have -- if there's going to be competition, consumers
5 are going to have to adjust to a lot of changes and already
6 have.

7 In most places in this country consumers have seen
8 the name of their local telephone company change without any
9 choice, so that problem can't be that significant, because it
10 was voluntarily embraced in 41 of the states here. BellSouth
11 got rid of BellSouth Wireless to go to Cingular, which I still
12 can't spell. I mean, the notion that consumers -- I mean,
13 consumers will adjust to new brand names out there, because as
14 a practical matter, the companies have already chosen to do it
15 for them.

16 This is only a question, I think -- and that's why
17 I'm not really hung up on whether it's a critical part of the
18 code of conduct or a less critical part of the code of conduct
19 because, I think, the brand-name issue has largely gotten
20 diffused a lot anyway. But there may be other competitors in
21 the room that disagree with me and in this proceeding that I
22 keep encouraging you to hold --

23 COMMISSIONER DEASON: Well, let me ask you this
24 question, then. The new retail CLEC, would they be subject to
25 service of quality regulation by this Commission -- quality of

1 service regulation or would we depend on the market to do that?

2 MR. GILLAN: No, that becomes another judgment call.
3 There are two issues there; one, should you be applying quality
4 service standards to competitors at all, which is one issue,
5 and depending on how you answer that, that would answer it for
6 this one. And then, even if you didn't apply it to competitors
7 generally, depending on how you address other issues like do
8 they get to use the BellSouth name, which in my mind, then,
9 might mean, okay, maybe they continue to have some quality of
10 service regulation applied to them, because by virtue of them
11 inheriting the BellSouth brand name, they're going to bring
12 with it the kind of customer loyalty and customer familiarity
13 that you referred to earlier; and, therefore, the Commission
14 might want to, for that retail CLEC, to continue some
15 additional regulation. The issues are linked -- in my mind,
16 the issues get linked in that way. If you make a clean break
17 in that CLEC and you put him out in a competitive market, then
18 the only question you address is do we do quality service
19 regulation for competitors? And how you answer that question
20 answers how you do it for this one.

21 COMMISSIONER DEASON: You may proceed.

22 MR. GILLAN: Actually, I think, I'm almost done,
23 which is good, because I think I've used all my time. Joe?
24 Ah, I think, this first one is very critical, because
25 fundamentally what we're trying to find here is an incentive to

1 want this to work. The second one is Commissioner Jaber's
2 comment about pricing becomes less critical of the UNEs,
3 because everyone has to live with it, but it doesn't mean that
4 pricing of the UNEs is not important. The OSS discrimination
5 becomes a lot simpler to address because we get rid of this
6 performance measure separate but equal thing and we get the
7 same. And I believe that over time we'll get this innovation
8 of competition to supplant regulation, at least that is
9 certainly the hope.

10 And just finishing up, obviously, I don't think you
11 should expect this problem to go away. Dependency on this
12 existing network is not going to change anytime soon. There is
13 no technology behind the common kahu-tech (sic) that's going to
14 solve this for us.

15 Managing these incentives through the police action
16 approach is -- I'm not even sure it's viable given where this
17 industry has gone in terms of its CLEC resources. The CLEC
18 industry today relies extensively on the resources of two
19 competitors. They may or may not stay in this marketplace.
20 Some other solution has to be found. And we believe that some
21 sort of structural incentive approach would be appropriate.

22 And if there's no other questions or --

23 COMMISSIONER JABER: To the degree that this
24 Commission might want to entertain functional separation with a
25 long code of conduct, is there someone that is ready to present

1 on what should be included in that code of conduct?

2 MR. GILLAN: Today?

3 COMMISSIONER JABER: From the FCCA.

4 MR. GILLAN: No. We would have to -- if the
5 Commission is interested in exploring that in this docket, then
6 -- and, I think, we're beginning to hear you -- we would be
7 prepared to give you sort of a plan A, plan B type approach, I
8 think.

9 As I indicated, the bottom line, what it all boils
10 down to is with functional separation; A, you have to at least
11 get them using the same OSS or I'm not sure what you've got.
12 And then, you'd still have these economic issues, but we would
13 be prepared to develop a code of conduct that identifies what
14 we believe would be all the remaining problems and put
15 something out there for discussion in later phases.

16 COMMISSIONER DEASON: Okay. Thank you.

17 MR. GILLAN: Thank you.

18 COMMISSIONER DEASON: I believe, the schedule calls
19 for the next presentation to be AT&T; is that correct?

20 MS. LOGUE: Yes, sir, that is correct. The next
21 presentation is by AT&T, and they do have a variety of
22 presenters on various issues.

23 MR. LAMOUREUX: Just very briefly to introduce our
24 folks again, we have several presenters. Michael Morrissey,
25 with AT&T, who is the Vice President of Law and Government

1 Affairs for our Eastern Region will be our first presenter,
2 then we have Dr. Lehr with M.I.T. will be after that, and then
3 Peter Bradford, who is a former Commissioner of New York and
4 Maine, and then Judy Sheldrew, former Commissioner with Nevada,
5 and then Bill Graham, and then briefly myself.

6 Mike Morrisey, Dr. Lehr, Commissioner Bradford,
7 Commissioner Sheldrew, will be addressing various aspects of
8 Issues 2 through 4. Bill Graham will be addressing Issue 5,
9 very briefly, and I will very briefly address the last issue,
10 which is Issue 6.

11 MR. MORRISEY: Let me do a sound check. Can you hear
12 me? Okay, thank you.

13 Good afternoon, Commissioners. Thank you for having
14 me here. I appreciate the opportunity to speak to you on this
15 issue. Before I start, I was kind of struck this morning by
16 Mr. Lackey's presentation, and I'd like to amplify on the
17 parts --

18 COMMISSIONER DEASON: Mr. Morrisey, you may want to
19 speak a little louder or move the microphone just a little bit.

20 MR. MORRISEY: All right. Is that better,
21 Commissioner?

22 COMMISSIONER DEASON: Yes.

23 MR. MORRISEY: Okay -- amplify on the statements that
24 Mr. Gillan made about, you know, who the parties are in this
25 case and what is at stake. It has been pictured, sort of by

1 Mr. Lackey, that this is AT&T versus the RBOCs. That's not the
2 case. I mean, I wish it were that simple. In a number of the
3 states that were reported by Mr. Williams this morning and by
4 various other speakers, particularly, Maryland and
5 Pennsylvania, AT&T was not the originator of the structural
6 separation concept in Pennsylvania. In fact, it was the
7 Commission that initiated. Did we support it down the road?
8 We did, of course. We think it has a lot of merit. And in
9 Maryland the legislation was initiated by another ALEC through
10 its delegate. We, of course, provided support after it was
11 introduced.

12 We certainly filed the position here in Florida and
13 we don't stand back from that. We're very concerned about this
14 issue. Some of my remarks will dovetail with some of the
15 remarks that Mr. Gillan made, and that's not surprising since
16 we're both in the same position in the industry. We, like the
17 people that he represents, are, for purposes of this docket, an
18 alternative local exchange carrier. In fact, we are the
19 largest alternative local exchange carrier in the country, and
20 we are facing the same problems that other alternative local
21 exchange carriers face.

22 From an advocate's point of view, and in my past life
23 I was an advocate and, I presume, I still am to some extent.
24 Now, I think, to respond to Mr. Lackey, I would have loved to
25 have had, you know, Teligent be here, Viatel be here, Windstar

1 be here, Acute1 be here, E.spire be here, all companies who did
2 business in Florida who have gone into bankruptcy since the
3 beginning of this year. That kind of indicates the state of
4 the marketplace which, I think, Mr. Gillan detailed quite
5 convincingly. I'm going to touch on that briefly and also
6 harken back to a comparison of where we are now, you know,
7 fives years after the Telecommunications Act and where we were,
8 essentially, five years after the divestiture in 1984.

9 I'm not proposing a divestiture process here. I
10 think, there's a lot of merit to the structural separation
11 proposals that have been put in place in terms of a division
12 between resale and -- retail and wholesale, but I think some of
13 the incentives that were presented in the -- what I'll call a
14 more severe form of structural separation; that is divestiture,
15 I think, are lessons that can be learned. There were some
16 lessons from the long-distance experience that were not learned
17 in the Telecom Act of '96, and I think that has led us to why
18 we're where we are today.

19 Since 1996 we have seen, rather than the creation of
20 competition in the local exchange market, certainly for
21 consumers, not that development. There's been more of a
22 remonopolization and consolidation. When the Act was passed
23 there were at least eight major local exchange companies. That
24 is now down to four. There has been very little penetration
25 into the residential market. There has been some successes on

1 the business market, more at the high end than at the low end.

2 There's also been a monopolization of the DSL market.

3 If I gave this presentation in just February of this year, I

4 would probably have had a handout that said the regional bell

5 operating companies now control 75% of the DSL market.

6 According to "USA Today" of about a month ago and the "New York

7 Times," that share is now 92% since February. And you've read

8 about the demise of various DSL providers, such as Northpoint

9 and others. There's also been limited inroads of competition

10 for consumer local service. You've found that the impact in

11 residential service has maybe declined from a market share in

12 the high 90s to the low 90s overall and in the residential

13 market probably in the 3 or 4% range.

14 There have also been record fines for regional bell

15 operating companies nationwide for poor service quality. In

16 2000 alone they totaled approximately \$370 million. I know

17 from my experience in New York, last year Verizon paid my

18 company \$22 million in rebates because of the poor operation of

19 the operating support systems. This year we're on track for

20 \$26 million.

21 While we appreciate the oversight the New York

22 Commission instituted and the rebates that we get, I don't

23 think the Act really envisioned my organization as a revenue

24 source, you know, under the new competitive environment. Some

25 of this information almost gets dated daily in terms of where

1 this capitalization was of what we call CLECs or ALECs a year
2 ago and roughly now. And these companies, some of them are
3 familiar to you. If I had to do Teligent now, it's kind of up
4 in the air. The number under the current might actually be
5 zero, since they're close to being bankrupt, but there is a
6 dramatic drop, and Mr. Gillan talked about that.

7 We have not been immune on the interexchange side.
8 AT&T, MCI, Worldcom, and Sprint, our capitalization has changed
9 dramatically. I'm sure the charge will be made over the next
10 couple of days that the failure of the ALEC or CLEC industry
11 has been down because of bad business plans. I'm sure there
12 are some companies who did have bad business plans, but we're
13 talking about the industry as a whole, and including AT&T. And
14 obviously, we've made our share of mistakes, but the industry
15 as a whole has had a bad business plan, and that bad business
16 plan was believing in the promise of the Telecom Act.

17 These business plans were generated by what we
18 believed the Telecom Act was going to produce. And a number of
19 us have spent a lot of money, you know, attempting to bring
20 that promise of that Telecom Act forth and it has not
21 developed. Let me move, quickly, again, back to comparing what
22 happened with the AT&T divestiture in '84 and the Telecom Act
23 of '96.

24 In 1984, there was, as I say, the drastic divestiture
25 of the local operating companies from AT&T. In 1984, AT&T

1 accounted for approximately 90% of all interLATA toll revenues.
2 By 1989, five years after the divestiture, this had dropped
3 almost 23 percentage points, and since 1989 our shares have
4 ranged in the 40%; lower in some states, higher in others.

5 In Connecticut, for instance, we are not the longest
6 residential long-distance provider. That belongs to SBC SNET.
7 And my guess is within another year in New York, Verizon will
8 be both the largest long distance and local provider of service
9 in New York. In contrast to that, five years after the Telecom
10 Act, ILECs still accounted for roughly -- oh, in 1996 they
11 accounted for roughly 97% of all local telephone lines, that's
12 both business and res. Five years later, it only dropped by
13 four points to 93%.

14 I know that the FCC has issued a recent report on the
15 state of competition and was heralding the increase of the
16 beginning -- or the end of 1999 until the end of 2000.
17 However, if you do read the report, most of the gains were made
18 in the first half of the year. There's been a severe dropoff
19 in the last half of 2000, probably directly correlated to the
20 failures of various CLECs and ALECs.

21 Also, interestingly enough, for the first time since
22 records have been kept in the first quarter of 2001 there was
23 actually a drop in people who had access to the Internet on the
24 residential side. I'm not talking about a drop in the growth
25 rate. I'm talking about an actual drop in the number of people

1 who had access to the Internet. That's an interesting
2 phenomena. It may be caused some by economic conditions. It's
3 certainly caused, in part, by a number of DSL companies going
4 under and stranding some of their customers, but that's the
5 first time it's happened since records have been kept of that
6 phenomena.

7 I'd like to contrast, again, what has happened
8 between the long distance and the local. The reason I use the
9 long distance is, as many of you know, the 1996 Act was based
10 on a number of assumptions. One was they'd hoped to learn the
11 lessons of the long-distance market which, certainly by 1996 by
12 all accounts, had been successful in terms of bringing
13 competition to long distance. No one seriously debates as to
14 whether the long-distance market is competitive. Verizon and
15 BellSouth will say it'll be more competitive if they're in so
16 that when you add, you know, interexchange carrier number 536
17 and 537 there will be more competition.

18 Long-distance demonopolization resulted because
19 regulators took a series of strong actions to ensure that bell
20 operating companies, new IXCs and AT&T would have the proper
21 incentives, and that's the key word, the incentives. I know
22 we've gone around today in terms of the puts and takes of what
23 kind of structural system should be in place, but the clear
24 theme is you have to have the structure in place that gives the
25 incentives to the particular parties to act in a

1 pro-competitive way.

2 In the long-distance side we had equal access
3 initiatives. AT&T paid for the conversion of all central
4 offices so that you can electronically change from one carrier
5 to another. That conversion was done at or ahead of schedule,
6 and AT&T paid for it.

7 There were access charge incentives in terms of big
8 discounts on access charges to competitive interexchange
9 carriers. There was rigorous regulation of AT&T and
10 limitations on its flexibility. And last, again, I'm not
11 proposing this, but there was the complete divestiture of AT&T
12 and the BOCs.

13 If we contrast where we are now, there have not been
14 equal access by ALECs and CLECs to the ILEC networks and
15 systems. CLECs have been required to pay more than the ILECs
16 cost for what we perceive to be the inferior access that we
17 have been granted and the \$22 million and 26 million in rebates
18 in New York alone is an example of that type of inferior
19 access. ILECs have been granted extensive flexibility and are
20 in the process of being deregulated. ILEC retail operators
21 have not been set for wholesale operators.

22 In addition, as I've mentioned, there was a
23 substantial discount on the access services that were deemed to
24 be not equal. There's an equal charge rule required in terms
25 of for tandem support versus dedicated transport, and the

1 five-mile rule was put in place so that new entrants were put
2 on the same footing as AT&T in terms of their cost
3 consequences.

4 That has not occurred on the local side. These are
5 proposals that would parallel the proposals that occurred in
6 the long-distance initiative. I have down there until ten
7 years have elapsed or per unit charges to CLECs for any UNE or
8 TSR service shall not exceed charges to the ILEC for the
9 equivalent services. Ten years isn't magical. I just happened
10 to use that, because that seemed to be the period of time that
11 that happened in the long-distance market. If, in fact, you
12 find a competitive marketplace developing in five years or four
13 years or three years, you know, so be it.

14 In addition, under long distance, AT&T was regulated
15 as a dominant carrier. People have kind of an amnesia about
16 how fast things happened for AT&T after divestiture. AT&T was
17 not declared a nondominant carrier until 1995, 11 years after
18 the divestiture. AT&T remained at a rate of return strictures,
19 and there's no relaxation of AT&T's regulation until its market
20 share had dropped below 70%. Again, 70% isn't magical, but it
21 certainly gives you a frame of reference in terms of what
22 market conditions were in place when actions were taken or
23 applied to AT&T.

24 AT&T's required to maintain nationwide average
25 pricing and little or no contract pricing, other than for large

1 business customers and, specifically, not for switched or
2 dedicated services, and is a mandatory resale of all services
3 without restrictions. The same type of parallel requirements
4 have not been applied directly to the incumbent local exchange
5 carriers, and they should.

6 And finally -- and again, I'm not proposing this
7 here, but to indicate what did happen and how and what worked,
8 there was a complete divestiture. There was full structural
9 separation, the fullest structural separation you can get, no
10 use of the Bell brand name by AT&T. The bell operating
11 companies were put into seven entities, and they were
12 prohibited from competing with their access customers. The
13 same type of incentives of structural separation, while not a
14 complete divestiture, needs to be put in place in terms of a
15 split with the local operating companies in order to develop
16 those incentives.

17 In terms of the implementation issues, the challenge
18 will be to determine whether there is any incumbent local
19 exchange carrier separation methodology short of complete
20 wholesale retail business divestiture that will allow
21 demonopolization and competition to occur. And, I think,
22 that's what you're addressing in this workshop and hopefully
23 going forward from here.

24 For long-distance policymakers, determine that
25 regulatory policy actions alone would be insufficient and,

1 thus, these regulatory actions were augmented by divestiture.
2 It raises the question why should we expect less vigorous
3 regulatory actions be successful in the local business, which
4 five years after the Telecom Act remains more monopolized than
5 long-distance was, even before divestiture.

6 I'd like to talk also a little briefly in terms of
7 what has not worked, the status in other states. I know Mr.
8 Lehr's going to give a very fine, you know, summary of around
9 the country. And finally, the Pennsylvania story, there's been
10 much reference to that.

11 What has not worked? The 271 process has not worked.
12 It was the carrot that was supposed to incent the local
13 exchange carriers, the incumbent local exchange carriers, to do
14 the pro-competitive things necessary to produce the competitive
15 benefits of the Telecom Act. It did not work. Reparations and
16 fines have not work. As I indicated, there's been \$370 million
17 in fines paid in the year 2000. I notice that SBC and
18 Ameritech was fined again last Thursday, another \$3.5 million,
19 for failure to comply with their merger agreements.

20 The status in other states -- I'll focus on a few of
21 those states. In Illinois, a reference was made to the fact
22 that, quote, "The Illinois legislature rejected structural
23 separation." I would guess that's technically true, but what
24 they did instead is they did a massive rewrite of the
25 telecommunications legislation in Illinois which was very

1 pro-competitive, probably the most demanding legislation in the
2 country. In press reports prior to the passage, SBC Ameritech
3 claimed that if passed it would bankrupt them, and there was a
4 shock, it was passed virtually word for word. In the words of
5 the "Chicago Tribune," it appeared that SBC and Ameritech had
6 become a political unit.

7 Interestingly enough, there were structural
8 separation provisions that were dropped from the legislation as
9 finally written as was a forced access type piece of
10 legislation that was introduced by the regional bell operating
11 companies. One would sense there may have almost been a
12 tradeoff.

13 In Maryland, as I indicated, the legislation was not
14 pushed by AT&T initially. We did support it. There was some
15 -- a lot of resistance from Verizon, and its lack of acceptance
16 in Maryland -- it was, by the way, removed for summer study
17 along with their Telecommunications Act, was spearheaded by a
18 very powerful chairman of the committee that was referred to
19 this morning, Senator Gunn, who also happens to be a Verizon
20 employee. He is not running for office again, and I would not
21 be surprised if you don't see structural separation legislation
22 in Maryland in the future.

23 And finally, I'll turn to Pennsylvania. Pennsylvania
24 is an interesting story. Again, contrary to the impression
25 given this morning, AT&T did not institute the structural

1 separation fracas in Pennsylvania. It was instituted by the
2 Pennsylvania Commission after a three-year global -- what they
3 called a global docket to look at the state of local
4 competition in Pennsylvania. They found that the state of
5 competition to be wanting and they further found that in their
6 opinion it was caused by the blocking tactics and
7 discriminatory actions of the incumbent local exchange
8 carriers. As a result, the proposed structural separation.

9 AT&T certainly supported that view after the
10 Commission announced it. We did support structural separation
11 in Pennsylvania, and we were part of the docket. The initial
12 decision by the Commission was appealed to the Commonwealth's
13 Court which upheld it unanimously. When the final decision was
14 issued after the administrative law judge had also recommended
15 structural separation, the Commission decided to go with a less
16 -- in their view, less onerous functional structural
17 separation.

18 Why that occurred is open for speculation. One of
19 the other dockets that was established out of the Pennsylvania
20 decision was a sanctions docket against Verizon for a
21 misleading public campaign, which thwarted the regulatory
22 process on structural separation. It became very politicized
23 in Pennsylvania. And to say that there was a political
24 decision in this would be a vast understatement.

25 However, the Commission did say that structural

1 separation, real structural separation, has not gone away in
2 Pennsylvania. They will attempt to have Verizon comply with
3 what they call a code of conduct and functional structural
4 separation. And if that fails they will revisit the issue of
5 actual operational and structural separation. So, it is not a
6 dead issue in Pennsylvania.

7 In a country at large this is a very early
8 development in terms of the consideration of structural
9 separation. It has very much cropped up outside of
10 Pennsylvania only within the last six to eight months. There's
11 early deliberations about it. There's a lot of discussion back
12 and forth on the issue, but I think what has caused the issue
13 rather than structural separation itself, which becomes the
14 buzzword for discussion is really how do you deal with the
15 remonopolization of the telecom industry, specifically for
16 residential customers?

17 Those of you on this Commission or other Commissions
18 have labored mightily, you know, through various types of
19 proceedings through UNE price cases to OSS, collaborative
20 processes, and yet after five years that competition is still
21 allusive. There seems to be, you know, something amiss. And
22 while, you know, AT&T is certainly a participant in this, we're
23 certainly a business, we certainly have a vested interest.

24 The Telecom Act does not mention AT&T. This Act was
25 not for AT&T's benefit or detriment, but I'll submit to you

1 that every person who signed on to that Telecom Act probably
2 had in their mind that AT&T was one of the players who they
3 viewed would be a new entrant in the local business.

4 And so, while AT&T certainly should not be the focus
5 of whether competition has succeeded or not, we're certainly a
6 good litmus test. And if neither we nor anyone else is
7 succeeding, it has to tell you that something is fundamentally
8 wrong with the way we've been doing for the last five years.

9 And with that, I'm finished. Do you have any
10 questions?

11 MR. LEHR: I'm Bill Lehr. I'm an economist at M.I.T.
12 I'm very pleased to be here and honored to be able to address
13 the Commission today about what, I think, is a really important
14 issue. I'm speaking here today on behalf of AT&T.

15 I'm going to talk about three things. First, I'm
16 going to try and frame what I perceive is the problem, why
17 we're here and why I think structural separation is a relevant
18 thing for the Commission to be considering; why I think that
19 the goals of promoting local competition under the framework
20 that was established by the Telecommunications Act of 1996 is
21 not working, what the problems are and why it needs to be
22 changed, and then talk a little bit about the costs and
23 benefits of structural separation.

24 First, let's be clear, telecommunications is not like
25 bubble gum, it's not like records, it's an essential service.

1 You can't operate a business today, a small business, big
2 business, doesn't matter what kind of business, in today's
3 information economy and not have telephone service and mostly
4 increasingly all of the other services we associate with that.

5 Residences, consumers consider telephone service to
6 be an essential service. It's a very important part of our
7 whole economic infrastructure. Local telephone service is the
8 most essential element of a natural bundle of
9 telecommunications services. Joe Gillan already mentioned, but
10 I think it's no surprise to people that in the long run if we
11 look to a world where competition and telecommunications
12 services will succeed, and that's why we're here, we're all
13 trying to make that happen, if you can't offer local telephone
14 service, you're not going to be able to really compete
15 successfully in that world.

16 So, it's not an option, for example, for the CLECs or
17 ALECs to be able to compete in this world if they can't
18 actually offer local service. They can't survive just offering
19 long-distance, for example, or just offering Internet service,
20 not in the long run. It's also, I think, a fact that BellSouth
21 owns the only ubiquitous network in its territory that's
22 capable of originating and terminating traffic, okay? There
23 isn't anybody else. You can go out there and look. The
24 networks just don't exist yet today to compete with what
25 BellSouth has in place.

1 If competition doesn't happen, then regulation is
2 what's going to have to happen. It's not an option to consider
3 control of these essential facilities, the local network, as
4 being something that will be controlled by an unregulated
5 monopolist, so it's really not an option to think that if it's
6 a competitive experiment that we've embarked on for the last
7 five years, over five years, if this fails, we're not going to
8 ever be able to realize what the original goal was, which was
9 to see a world with a lot less regulation, not more regulation.

10 There's a general belief around the world and
11 certainly in the United States that wherever competition can
12 work, it's superior to regulation and that regulation ought to
13 try and focus on the minimum set of economic activities to
14 where it really has to be. The question is where competition
15 can work when it's feasible, okay?

16 Competition can't emerge without access to the
17 BellSouth network. Everybody's recognized this. The Telecom
18 Act of 1996, its whole premise in terms of creating the
19 framework for how local competition would emerge is premised on
20 the idea that they had to create a way so that competition
21 could get access to the network. The local network is what
22 economists will refer to as a bottleneck facility. It's an
23 essential element of what it takes to compete in the business
24 of telecommunication services.

25 Next slide. So, why is the local network a

1 bottleneck? Okay, economist-speak. Well, First, as I said,
2 it's an essential element of most, if not all,
3 telecommunications services. First, most obviously, you know,
4 if you don't have the local network, you also can't offer local
5 telephone service, you also can't offer long-distance service,
6 you can't offer Internet access, you can't offer broadband
7 Internet access over DSL services and you won't be able to
8 offer a lot of the other kinds of services that folks are
9 talking about. Even, for example, a service like cellular you
10 need to be able to terminate calls across the local networks.
11 The local network, the ability to terminate calls ubiquitous to
12 all these homes, is still an essential facility.

13 What's the problem? Why, if this is such an
14 important asset, why aren't there lots of competing networks?
15 Well, the problem is because the economics of constructing
16 local infrastructure are difficult. BellSouth has billions of
17 dollars of investment in place of a network that took them 100
18 years to put in place under a regulatory regime that protected
19 them from any kind of competition for a very, very long time.

20 There's a lot of fundamental economic characteristics
21 of what it takes to be a local telephone company that make it
22 very hard for anybody to come in and just duplicate these
23 facilities and say, okay, if I can't get them to cooperate with
24 me, I'll just go out there and build completely substitute
25 facilities.

1 First, you have all these economies of density,
2 scale, and scope associated with the basic network, okay? When
3 you go in and dig up the streets in a neighborhood, those costs
4 are very high and you're putting them in, they depend on the
5 number of houses you pass more than they depend on the actual
6 usage you're going to get from individual subscribers.

7 There's also network externalities, the idea that
8 basically big networks, especially with communication networks,
9 are more valuable to the subscribers than are small networks.
10 So, a really big network, if it can deny equivalent
11 interconnection to smaller networks, can basically starve them
12 of customers, because customers will say I don't want to be
13 part of a telephone network that only allows me to call two or
14 three people, okay? I need to be able to call everybody. And
15 fine; the underlying cost structure is substantially fixed,
16 sunk where there's lots and lots of shared cost, okay? You
17 build these networks to handle peak traffic, which means that
18 again these are all the reasons why some people have
19 characterized telecommunications as being a natural monopoly.

20 I do not believe it's a natural monopoly, and my
21 belief in why structural separation is a good thing does not at
22 all depend on an argument that it be a natural monopoly. But
23 let me be clear, if you really think this is a natural
24 monopoly, then to me, the idea of structural separation makes a
25 ton more sense, because at that point, then, if you really

1 think this is a natural monopoly and, I think, this is an
2 interesting question if you look forward and you say, okay,
3 fiber to the home, is that a natural monopoly? And if it is,
4 then, if that's really the life, but there's only going to be
5 one company providing it, I'm going to have to regulate that,
6 and I don't want to have to regulate all of the other services
7 that might be offered over that. We're not there yet today.
8 We don't know that. I, honestly, don't think it will be a
9 natural monopoly, but it might be, but if you think it's a
10 natural monopoly, then the structural separation argument, to
11 me, almost becomes, from an economic perspective, relatively
12 trivial.

13 We certainly have a legacy of regulation when we have
14 a monopoly of this essential facility. We have price
15 regulation that goes back from the history of this industry and
16 all kinds of service regulation and all kinds of different
17 structural remedies that have been used as a way to manage the
18 regulation of this very important facility.

19 So what did the Telecommunications Act of 1996 do?
20 Well, that framework tried to say, okay, let's see if we can
21 put in place a set of rules that are not as severe as full
22 divestiture or full structural separation that will still
23 assure competitors equal access. And, you know, that's the
24 unbundled network elements provisions, the total service resale
25 of the interconnection, the idea that basically competitors

1 will have access. It's the same way in which BellSouth's
2 retail operations have access to the underlying network
3 services and have a level playing field. That did not
4 eliminate all the economic entry barriers, there was never an
5 attempt to eliminate all the entry -- economic entry barriers.

6 People still understood that there would be fixed
7 cost, a large cost associated that would be associated with
8 entry into this market, that until those competitors could
9 actually take advantage of these scale and scope economies
10 associated with the advantages they had under things like the
11 UNE provisions, they would still have much, much higher costs
12 than BellSouth, but if they wouldn't have such high costs they
13 wouldn't be able to compete, okay?

14 They require the ILECs to negotiate interconnection.
15 There was this belief, the Telecom Act, that actually with the
16 carrot of promise the interLATA competition, and the stick of
17 Public Service Commission and FCC enforcement between those two
18 things you could actually get them to sit down and negotiate
19 agreements that would be analogous to what would parties that
20 had a mutual business interest negotiate.

21 Next slide. So has it worked? No, it has not
22 worked. It hasn't worked. We've already heard about the state
23 of competition. I mean, the statistics, I think, are pretty
24 obvious. In Florida, alternative local exchange carriers are
25 still only serving something like 6% of the lines and the

1 numbers differ, depending on who you pick.

2 The point is anywhere you look it's substantially
3 less than 90% of the lines. And what competition we have is
4 still wholly dependent on access to the underlying ILECs
5 facilities. You still have to have BellSouth capabilities to
6 even to take advantage of this. And it's worse if you look at
7 rural or residential small business customers, because where
8 you see the competition is principally in the places where it
9 makes the most sense to build in the alternative facilities and
10 the competitors that are doing the best are the ones that can
11 do a facilities-based investment where they don't have to rely
12 on access to the underlying network, and that's only in fairly
13 limited situations.

14 And you know -- okay, market share makes the point so
15 clearly you don't even need to look at all the other stuff, but
16 if you do look at the other stuff, you see a similar thing.
17 The level of plant in place, the level of assets on the ground
18 that BellSouth has, compared to any ALEC, compared to all of
19 them collectively so dwarfs what they have as to make it clear
20 that they still are have this huge asymmetry of position.
21 Similarly about investment, customer awareness, et cetera.

22 The conclusion is that BellSouth remains a de facto
23 monopolist; whether or not it's a natural monopoly or not, I
24 don't know. I don't believe so, but it's certainly the case
25 they're a de facto monopolist, and without access guaranteed by

1 regulation to this network, you're never going to see
2 competition.

3 Next slide. What's the problem? Well, it's really a
4 problem of institutional -- regulatory institutional process.
5 Basically, delay, delay, delay; stop implementation, have
6 another process, have another proceeding, that always is going
7 favor the ILECs, because remember the name of their game. They
8 don't want this process to succeed.

9 Now, can you say they don't have a right to appeal
10 decisions they think are wrong? Of course, not. You can't
11 eliminate the due process rules. They're very much part of
12 what you have to have in a regulatory system. The problem is
13 that all these due process rules that exist for very good
14 reasons can be abused by a participant who has this asymmetric
15 interest in delaying the process.

16 On the other hand, the competitive local exchange
17 carriers are sitting here hemorrhaging from fixed cost
18 investments they have in place that they're not able to take
19 advantage of, okay? Similarly, there's lots of evidence that
20 UNE pricing doesn't allow adequate margins at its current
21 levels. I have not looked in detail what the situation is in
22 Florida to compare that with cost to whether or not, I think,
23 they're too high, et cetera. I've certainly seen evidence
24 around the country that there's problems here.

25 I think, one really telling point to note is look at

1 what the ILECs -- look at what Verizon and SBC are doing with
2 respect to their out-of-region commitments in terms of
3 investing. They're backing off. They can't do it. They can't
4 do it -- you know, Verizon's pulling out of Texas, SBC's
5 pulling out of a bunch of different markets, because they can't
6 see competing in, because they understand something that's
7 clear to everybody else. If you can merge your way into a
8 market, that's better, but competing, trying to do what you're
9 asking all the other ALECs to do just isn't a viable business
10 proposition.

11 Why? Why are there all these problems? Well, first,
12 this is a complex and evolving problem. There's nothing you
13 can do about that. Second, the ILECs have a very strong
14 incentive to discriminate and, I think, there is something you
15 can do about that.

16 Next slide. The whole point of structural separation
17 in all of the different proposals we've heard today and have
18 been talked about and all of its different flavors are all
19 about trying to get the incentives right so that the provisions
20 of the Telecommunications Act in 1996 and the goals that
21 inspired it have a better hope of working. It can work more
22 efficiently.

23 Today, when you've got BellSouth both controlling the
24 essential facility and being a direct retail competitor of the
25 people that absolutely have to depend on access to that

1 facility to be able to compete, you have a natural incentive
2 for them to discriminate against their rivals, and there's
3 umpteen million ways in which they can do that. Their idea is
4 to basically just make it harder for their competitors to
5 succeed against them.

6 The first thing they try and do is they try and get
7 prices to be higher, so you always know which way they think
8 costs should be, and so you've got this business about, you
9 know, arguments, the price, the war of the cost models; or they
10 can lower quality to rivals, that's the other way in which they
11 do it. But quality is a much harder, it's a much more
12 difficult thing to figure out how you're going to regulate,
13 especially with a complex and evolving product like
14 telecommunications, you know, the death of the thousand cuts.

15 So today, it's because I can't match up maintenance
16 records, because the OSS system -- oh, well, that's a software
17 glitch, okay, so fix that. See, we fixed it, but meanwhile, I
18 lost three or four customers. Tomorrow it's something else,
19 you know, and this is just fundamentally part of the problem.

20 So, the idea is to structurally separate BellSouth
21 into a wholesale/retail arm. The wholesale, the point of it,
22 the key point of it is you've got to figure out a way to do
23 this so that they view all of the ALECs the same, including the
24 BellSouth retail arm, okay? And it's most important they do
25 that with respect to new services and new customers, all right?

1 Because that company's looked to the future when they figure
2 out if I'm making an investment, and that's the most critical
3 place to focus.

4 You've got to put BellSouth retail on a level playing
5 field with all of the other ALECs and, I think, we've seen a
6 lot of the problems of having people use separate but
7 supposedly, quote, equal OSS systems, and the problems of
8 having to verify the test procedures, et cetera.

9 And one of the key advantages of this is now
10 BellSouth and the regulators' incentives regarding
11 nondiscriminatory access are going to be aligned. BellSouth
12 wholesale will no longer have an incentive, if you get this
13 right, to discriminate in favor of BellSouth retail, okay? And
14 that's going to be a difficult -- compared to how you do that,
15 that's going to be more or easy.

16 Next slide. Okay. Structural separation works.
17 We've already heard about the role it played in AT&T's
18 divestiture. I won't belabor that, but I think it's a really
19 telling example. There's also structural remedies common in
20 lots of other regulated industries, electric power --

21 CHAIRMAN JACOBS: I was going to ask about that. I
22 saw a reference, I believe, it was in the Pennsylvania order of
23 Connecticut example and a Rochester example; are you familiar
24 with those?

25 MR. LEHR: I'm not actually familiar enough with the

1 specifics of that.

2 CHAIRMAN JACOBS: Okay.

3 MR. LEHR: But those are both two examples. The
4 point is there are lots of examples, and one of the things that
5 I think this workshop's supposed to do and hopefully will do is
6 start looking at these examples and it shouldn't be thought
7 about as this monolithic proposal that if you like that, then
8 the whole thing has no merit at all. I mean, I think, what
9 we're trying to do is get thinking about what these different
10 structural remedies are.

11 So, the goal is to create this framework for
12 independent incentives and decisionmaking. You need something
13 more than just accounting separation. The economics
14 literature's pretty clear that if all you do is just change the
15 way you do cost accounting that, in itself, is not going to do
16 it, so you need more than that. What you're going to need,
17 exactly, do you need to do what Joe Gillan was suggesting or is
18 there some intermediate line, do you need to go all the way to
19 full divestiture? I'm not prepared to make a judgment on that
20 now. I certainly don't think there's been enough evidence yet
21 to figure out what it would take or are there some other
22 options open that are worth considering.

23 You need to have a situation where the wholesale
24 company has an incentive to sort of share information and
25 systems on a symmetric basis across all of the competing ALECs.

1 If they don't have this incentive to, basically, you know,
2 whisper in their retail arm, they'll swear the next place you
3 should be focusing on customers are, if you were to offer
4 discount to these customers, you'd make it very hard for this
5 particular CLEC that we're worried about to compete with us. I
6 think, you'd probably have to have separate personnel, if
7 you're really going to get separate decisionmaking.

8 Do you need separate ownership for divestiture? I
9 don't know. I'm not sure. I think, Joe Gillan's thing has a
10 lot to recommend it, the idea of some sort of partial
11 divestiture. It certainly has not very nice attributes in
12 terms of how you'd implement it. These are lots of details to
13 work out.

14 Next slide.

15 COMMISSIONER JABER: On Mr. Gillan's proposal, the
16 middle ground proposal --

17 MR. LEHR: Yes.

18 COMMISSIONER JABER: Can you comment a little bit on
19 that? Would AT&T agree with that middle ground?

20 MR. LEHR: I honestly don't know what AT&T's position
21 on the details of the structural separation proposals are. In
22 principle, I think that there's an openness to consider
23 alternative ways of achieving this. I don't know, for example,
24 if it's 60/40, what's the right level you need to spin off, how
25 would you do it? So --

1 COMMISSIONER JABER: You talked earlier about only a
2 handful of CLECs being able to be -- being able to enter the
3 market as facilities-based companies. If we were to consider
4 Mr. Gillan's proposal, a retail CLEC that had some financial
5 backing by a BellSouth holding company, from an economic
6 standpoint, might want to enter the market as a
7 facilities-based company.

8 MR. LEHR: Yes. And I actually don't immediately see
9 a problem with them doing it. If, for example, you adopt the
10 Joe Gillan thing, if you did something like switch all the
11 retail customers over so now they're monopolists in the retail
12 market, then, you know, them being a facilities-based provider
13 may have more problems associated with it. But especially
14 since there's going to be new services, the kinds of facilities
15 they would invest in, in exactly which facilities would you
16 regard still being bottleneck facilities and which you would
17 not, I think, are all things that would be -- have to be
18 subject to an evidentiary proceeding.

19 COMMISSIONER JABER: Well, but --

20 MR. LEHR: And I would think that potentially it
21 would. My long-run goal here would be that you shouldn't have
22 to be regulating BellSouth wholesale forever and that,
23 hopefully, and there may be some portions of the serving area
24 where you're just never going to see competitive entry. I have
25 one of the areas that right now is a real challenge are lessly

1 densely-populated rural areas, okay? I'm very interest, and
2 some of my research at M.I.T. in wireless solutions for that.
3 We think all that stuff's really, really wonderful.
4 Unfortunately, it's just not ready for prime time now. It's
5 certainly ready for some commercial experiments and you're
6 seeing that in places but it's not something -- I mean, you
7 can't hang your hat on it, this is going to be the solution
8 that's going to buy me out of this problem of bottleneck
9 facilities that we've been living with for, you know, 100
10 years.

11 COMMISSIONER JABER: Okay. But part of your
12 presentation is supposed to help us identify the problem, and
13 if I'm understanding your presentation, you identify the
14 problem as being one of there aren't enough competitive
15 providers in the local market and to the degree there is 6%
16 penetration and access lines, most of that is in the business
17 sector.

18 Now, I'm looking for the solution to the degree I
19 accept that that's the problem. I'm trying to understand how
20 the FCCA middle ground is a solution for the problem that
21 you've identified. It seems to me that it just creates a new
22 CLEC with a new opportunity to --

23 MR. LEHR: Now, the problem -- to me the basic
24 problem, and I haven't been as specific as Joe Gillan, because
25 I haven't thought as much about where you'd go in terms of

1 implementation with this, is control the bottleneck facilities,
2 and those bottleneck facilities are the local network. It's
3 largely, you know, the legacy, largely, sort of analog last
4 mile components that are the real problem. And if you had
5 multiple facilities-based alternatives ubiquitously available
6 as substitutes for that, you have some extra wireless cable.
7 If those things were really able to offer alternative facility
8 platforms, then this would no longer be thought, from an
9 economic perspective, as a bottleneck facility. Then, in that
10 sense hopefully the market would work much better.

11 When we can get there, will we ever get there, I
12 think, remains an open question. When I said that there's some
13 places where CLECs can enter, only a few CLECs can enter, it
14 was not so much a question of financial availability capital as
15 it was the attractiveness of certain types of markets. And so
16 if a market is dense enough, then given existing cost
17 technologies it can make sense to go in and do an overbuild.
18 And increasingly that appears to be the direction in which the
19 technology is involving to make that more possible over a wider
20 range of places.

21 We certainly, the folks I work with at M.I.T. would
22 love to see fiber into the home everywhere and lots of really
23 interesting wireless options, and we believe that those things
24 will come, but we just don't know exactly when. And in the
25 meantime, you have the danger of allowing a monopolist who has

1 the incentive to try and stop and block these sorts of
2 innovations that are a natural product of robust competition,
3 distorting the evolution of those markets. And that's the
4 reason why, I think, now, for example, now is the time. It's
5 really critical now to act. This is a window -- I think,
6 there's a real window of opportunity here.

7 When you talk about the cost of structural
8 separation, I wish I had empirical estimates of what these are.
9 I don't. I've seen various estimates, we heard some earlier.
10 Certainly they're the one-time cost of separation, but I have
11 not seen anything to me that persuades me that these are going
12 to be on the order of the billion dollars that the Verizon
13 folks, I guess, put forward in Pennsylvania.

14 It seems to me that most of the costs to the system
15 developments, a lot of the hard part of creating these
16 interfaces for the competitive industry to compete have already
17 been incurred in trying to implement the Telecommunications Act
18 of 1996, okay? That's the hard part. The part about what it
19 takes for a CLEC that can't be that hard, because look at all
20 the CLEC entry you've had. You've gone and tried to work with
21 these existing interfaces. Their problem is these existing
22 interfaces, the way they're currently construed don't work, and
23 we need to finish them, okay? But it's not creating them de
24 novo.

25 Also, I think, there are relatively clean functional

1 boundaries between the retail function and the networking
2 function. We're not talking about splitting the network into
3 this half of Florida and that half of Florida, that would be a
4 different kind of proposition. There are also these questions
5 in these large scale scope economies, the question is where are
6 all of those? The common cost of the costs that any firm would
7 have regardless of its scale, okay, so in that sense they're on
8 the order of magnitude of what the CLEC's common costs are,
9 right? And you need to look across and see what are the
10 different sizes of the CLECs? A lot of these costs are
11 variable and relate to the scale of operation in the market,
12 and as they scale up they'll take on these costs, but these
13 aren't new costs. And as I said, the network and the retail
14 are separate functions.

15 Next slide. What are the benefits? Well, first, I
16 think, one of the benefits is, you know, we are in crisis. As
17 Joe pointed out, structural separation is a strong remedy and
18 full divestiture is a very strong remedy, but we've tried
19 working with the Telecom Act of 1996, and I don't think it's
20 working, because it's fundamentally flawed in terms of what it
21 does with respect to the incentives. We're seeing a general
22 collapse of the CLEC industry. It's across the board.

23 And the reverberations are throughout the technology
24 sector, okay? Lucent, Cisco, all these companies are having
25 problems in part because of the failure of our ability to

1 unlock this last mile bottleneck, okay? Until consumers have
2 this last mile unlocked, you know, a lot of this stuff, we
3 don't need it, but there's a lot of people who thought that
4 this problem was going get solved. All the investment that
5 flowed into the competitive local exchange carrier business
6 following the passage of the Act in 1996 was all premised on
7 the fact that we would be able to do this and we still haven't
8 and now the markets are fed up and we're starting to see the
9 reverberations throughout the rest of the economy.

10 CHAIRMAN JACOBS: Are you familiar with the
11 legislation that was recently enacted in Illinois?

12 MR. LEHR: I'm not familiar in detail, but Joe was
13 telling me a little bit about that and, I think, he knows much
14 more about the details of that. My general impression is that
15 that's a really good thing. It demonstrates the ways in which
16 states can be proactive to try and supplement what happens at
17 the federal level, and I hope it works.

18 CHAIRMAN JACOBS: Well, beyond all the other
19 provisions, but they enacted specific structural separation for
20 reasons, actually in response to measures outside of OSS
21 specific -- oh, no, I think, there were OSS issues there. But
22 my reason for bringing the question up was your statement of
23 this broader response that goes beyond our traditional measures
24 and provisions, and I wanted to see if you were aware of in any
25 other states something like what happened there is anticipated.

1 MR. LEHR: I am not, and I certainly think that a
2 close tracking of what's happening in all of these different
3 venues is going to be a important part of this debate. And,
4 you know, as Mike Morrissey pointed out, this is really a
5 relatively new debate.

6 CHAIRMAN JACOBS: Okay.

7 MR. LEHR: Clearly here, but also all around the
8 country. And in Europe, they're talking about new kinds of
9 structural remedies in Europe also and elsewhere around the
10 world.

11 CHAIRMAN JACOBS: Thank you.

12 MR. LEHR: And all those issues, they all need to be
13 looked at. I just don't know the details of those individual
14 cases. You know, if you don't have competition to this really
15 critical thing, what's going to happen, you're going to see
16 higher prices, reduced employment, reduced economic growth,
17 evidence of the multiplier effects of benefits to the I.T.
18 sector are pretty substantial and huge.

19 Recent studies, you know, describe a very significant
20 share of the resurgence in U.S. economic growth from '95 to
21 2000 to information technology at large. And of that a
22 portion, obviously, is related to telecommunications. And a
23 number of folks are beginning to, you know, really look at the
24 problem of, you know, the continuing bottleneck at the local
25 loop. It's one of the few places where we've just not been

1 able to get effective competition.

2 Next slide. So, what are the conclusions? Well,
3 first we've got this local access bottleneck remaining and that
4 the current regulation or the Telecom Act of 1996 is not
5 working. The continuation of just having cost models, you
6 know, jockeying over UNE rates, move them up, move them down,
7 all of that is just going to be much more costly to deal with,
8 much more difficult in today's environment where you just don't
9 have incentives aligned right.

10 Structural separation, and the reason why it should
11 be considered in all its different flavors is it would align
12 incentives, and the other point is, I think, we just can't
13 afford to delay. We've sunk a lot of money in trying to create
14 this competitive experiment and the markets now have turned
15 against these firms.

16 Joe Gillan was mentioning what difficulty his clients
17 are having, and I've seen the same thing. I've talked to a lot
18 of people in this space, you know, a lot of electronic commerce
19 companies, et cetera, and a lot them had bad business plans, a
20 lot of them were entrepreneurs, but they have to be able to
21 even get a fair shot at making their business plans work, they
22 have to be able to have access to certain critical assets that
23 they just don't have access to today or on an equivalent basis.

24 So that's why I think it's really important that, you
25 know, today we look at this as the beginning of a process

1 that's going to take some time. And thanks, that's all I had
2 to say today.

3 CHAIRMAN JACOBS: Any questions? Thank you. We need
4 to break, otherwise, we'll lose our stenographer over here.
5 So, we'll take a break now and come back at 3:30.

6 (Recess taken.)

7 COMMISSIONER DEASON: We're a little behind on the
8 time. It's conceivable that we may have to work a little bit
9 late into the evening. So, it depends on the pace that we keep
10 from this point forward. With that, Peter.

11 MR. BRADFORD: Thank you. My name is Peter Bradford.
12 For 25 years I had the privilege of being a utility regulator.
13 Between 1977 and 1995, I chaired the Maine and New York utility
14 commissions and served one term on the U.S. Nuclear Regulatory
15 Commission. I was also president of NARUC and briefly Maine's
16 public advocate.

17 In recent years I've taught utility-related courses
18 at the Vermont Law School and at Yale University. I've
19 testified in a number of state Commission proceedings
20 concerning the introduction of competition into the former
21 monopoly utility industries, usually on behalf of Commission
22 Staffs or consumer groups.

23 My testimony as to telecommunications has been in
24 several different dockets in Massachusetts and in Pennsylvania.
25 I've not previously appeared on behalf of AT&T. I want to

1 speak today from my own experience as a regulator as to why
2 structural remedies seem central to remedying to some of the
3 problems that are dragging down efforts to introduce effective
4 customer choice into local telecommunications markets across
5 the nation.

6 The New York Commission's interest in establishing
7 telecommunications competition dated back into the mid 1970s.
8 The Commission set forth its fundamental principles favoring
9 competition in 1989. Though, we made some progress by 1994, we
10 were concerned that competition in the local exchange market
11 was still virtually nonexistent, and so we opened a further
12 inquiry into the transition of competition in the local
13 exchange market at that time.

14 That docket didn't conclude during my term, but the
15 Commission did approve a pioneering settlement in which the
16 Rochester Telephone Company restructured itself in a way that
17 included structural separation and opened its local exchange
18 market to competition in November of 1994.

19 During my New York experience, I encountered the
20 difficulties of opening local exchange markets to competition
21 and the willingness of ILECs to assert that such competition
22 exists when, in fact, it does not. As early as 1994, Nynex
23 later, of course, Bell Atlantic and then Verizon assured the
24 U.S. District Court for the District of Columbia that quote,
25 "competition in the local exchange in New York is a reality."

1 Of course, neither the district court nor later the FCC agreed
2 with Nynex in that claim.

3 As a result of this and other experiences I've become
4 a strong proponent of introducing competition where competition
5 can be effective, but I've also become extremely cautious about
6 moving toward deregulation or proclaiming the existence of
7 competition in situations in which successful competition
8 depends on regulators acting in a sustained policing role.

9 We're seeing proofs across the country now that the
10 introduction of competition into former monopoly sectors is
11 more difficult than was assumed, even five years ago.
12 Regulatory failure to match the pace of deregulation with
13 assurances that preconditions and protections of customer
14 choice are in place have shown that deregulation alone can be a
15 road to competition without competitors, to markets without
16 marketers, and to customer choice without alternatives.

17 In electricity especially but also in local
18 telecommunications, initiatives hailed just five years ago as
19 ushering in a new era of customer choice, threaten instead to
20 wind up among the great industrial policy fiascos in U.S.
21 history. At the very list, they are proving more expensive and
22 disruptive than necessary. At worst, they're leading
23 deregulated monopoly conditions that will be hard, either to
24 reverse or to transform into real markets.

25 A significant cause and consequence of these

1 developments is that Commissions have been given market
2 policing responsibilities for which they lack the resources,
3 and have become consequently mired in endless litigation and
4 court appeals. We know, on one hand, that where real
5 competition has been introduced, we've had scant cause to
6 regret it, but where regulators have opened markets in which
7 one competitor controls essential facilities without taking
8 care that that control cannot be abused, then the results are
9 very different.

10 The natural incentive of the incumbents is to use the
11 essential network to maximize their own advantage. Florida's
12 challenge, like that of many other states, is to create market
13 structures and rate plans that align BellSouth's self-interest
14 with Florida's announced public policy.

15 Structural separation can be an important step in
16 that direction. Before explaining this conclusion in more
17 detail, I want to stress the importance of having in mind a
18 reasonably clear concept of the term competition or meaningful
19 customer choice. While regulators can't set out to create a
20 given number of competitors with preselected market shares,
21 they do need to have some idea of what would be unacceptable
22 after several years and what they're prepared to do to prevent
23 such an outcome.

24 I venture with some confidence to say that a single
25 firm in control of all of the essential facilities and with a

1 market share above 90% five years after a legislature has
2 adopted pro-competition laws and policies is a result that only
3 the incumbent could love.

4 Of course, if the 90 plus percent market share
5 reflected a triumph of a single competitor based on customer
6 choice, then it would arguably be acceptable, but that is not
7 the case in any utility market. Instead, BellSouth's position
8 is the result of past state and federal decisions determining
9 franchise rights, exclusive service territories, and industry
10 structure.

11 This is significant, both because the monopoly
12 position is unearned and creates rights to monopoly power once
13 customer choice becomes possible, and because only the power of
14 government can effectively and quickly remove the barriers to
15 entry that past government policy has created.

16 You're hearing, of course, that such approaches are
17 Draconian, severe, radical, exorbitantly expensive, and a poor
18 reflection on the business climate in Florida. In substantial
19 part, this is a semantic war that George Orwell would
20 appreciate. Opponents of structural separation are literally
21 standing the English language on its head and are going to
22 great expense to do so.

23 In Pennsylvania, Chairman John Quain recently
24 initiated an investigation of Verizon's conduct in this regard,
25 charging that Verizon, and I'm quoting now, "appears to have

1 deliberately obstructed the orderly resolution of the
2 structural separation proceeding and has pursued an extensive,
3 systematic campaign of misinformation in connection with the
4 structural separation case. Verizon did this to portray
5 structural separation as leading to lost jobs and broad-based
6 negative impacts while Verizon threatened to relegate
7 Pennsylvania to virtual backwater status in the information
8 age." That's the end of the quote.

9 Commissioner Nora Mead Brownell, recently appointed
10 by President Bush to the Federal Energy Regulatory Commission
11 and at the time president of NARUC wrote last April, I'm
12 quoting again, "I'm appalled and saddened by what has
13 transpired during this case. A great disservice has been done
14 to ratepayers, public policymakers, and employees with a
15 campaign of misinformation and intimidation. The unfettered
16 assault on the integrity of this institution is an insult to
17 the very fabric of our civic tradition." That's the end of
18 that quote.

19 Now, as regulatory language goes, this is
20 extraordinary. Neither John Quain nor Nora Brownell are
21 radical Draconian or intemperate people, and I can count on one
22 hand the times I've seen language like this in the 30 years
23 since I first became a regulator.

24 While the incumbent monopolies go to such astonishing
25 lengths to portray structural remedies in alarming terms, it

1 seems necessary to ask whether it is really more burdensome to
2 take a one-time action, however noisily resisted it may be at
3 the time, than to permit a corporate structure that the record
4 shows will lead to years of subsequent litigation and
5 regulatory policing. Is it really less radical to reduce
6 regulation and open new businesses to a vertically-integrated
7 monopoly than it would be first to adopt structural solutions
8 that assure equal access by would-be competitors to essential
9 facilities.

10 Structural remedies have been at the core of most of
11 the successful introductions of customer choice and former
12 monopoly industries. Divestiture's a more far-reaching remedy
13 than proposed here, proceeded effective competition in
14 long-distance telecommunications services. Indeed, structural
15 separation was considered and rejected by the Reagan
16 administration, not because it was Draconian or drastic but
17 because it was an insufficient remedy to the market power of
18 the local telephone companies at that time.

19 Furthermore, separation of transportation from
20 ownership was essential to competition in natural gas and the
21 separation of transmission control from generation ownership
22 has been an essential step in all states that have restructured
23 their electric industries in recent years. Perhaps if we were
24 at the beginning of the road with no nationwide experience this
25 would be a theoretical debate in telecommunications and

1 allegations about the burden of proof being on the proponents
2 of structural approaches would be more credible, but that's not
3 where we are.

4 We have five years of experience, and this Commission
5 has this and other proceedings to review what has really been
6 going on out there. I've heard similar forecasts of burden and
7 of chaos from similar entities for a quarter of a century now,
8 usually in the face of efforts to devise needed solutions to
9 problems likely to raise future utility prices.

10 What I've learned from the broader business community
11 during those years is that a regulatory or a legislative
12 willingness to be hornswoggled into higher rates, excess
13 utility profits, or diminished customer choice will truly slow
14 growth and shape potential investor faith in any state. But
15 the ability to deal firmly, fairly, and promptly with the
16 challenges that confront these economically significant
17 industries is what will bring long-term economic benefit to
18 Florida.

19 Urgings to regulators structural remedies, far from
20 being somehow radical or disruptive, are an important part of
21 the introduction of competition in monopolized markets have
22 been with us for quite a while. A particularly, clear example
23 from Joel Klein, the former head of the Justice Department's
24 Antitrust Division went as follows: He told the FERC "Based on
25 a century of experience I would further emphasize that the

1 Department of Justice is also highly skeptical of any relief
2 that requires judges or regulators to take on the role of
3 constantly policing the industry.

4 Relief generally should eliminate the incentive or
5 the opportunity to act anticompetitively, rather than attempt
6 to control conduct directly. We are institutionally skeptical
7 about code of conduct remedies, the costs of enforcement are
8 high, and in our experience the regulatory agency often ends up
9 playing catch-up while the market forces move forward and the
10 underlying competitive problems escape real detection and
11 remediation.

12 In brief, structural separation substitutes economic
13 self-interest for regulatory oversight. In doing so, it aligns
14 corporate incentives with public policy goals and with the best
15 interest of the customers, which is a crucial objective of
16 successful economic regulation of any sort.

17 The marriage of monopoly facilities in competitive
18 lines and business is always problematic. Even with structural
19 protections, the incentives to exclude competitors and to
20 overcharge monopoly customers to benefit competitive
21 subsidiaries is very strong. Not one of my 25 years as a
22 regulator went by without a significant example of such conduct
23 making headlines somewhere in the country, and those were just
24 the episodes that were detected and publicized, and the
25 incentives for such conduct in those years were much smaller

1 than they are today.

2 The task of creating competition where it has not
3 existed before is fundamentally different from the conventional
4 antitrust mission of protecting markets that are already
5 competitive. Markets will not become competitive if we rely
6 primarily on existing antitrust laws and on the self-interested
7 decisions of the incumbent monopolists.

8 Their proper duty is the enhancement of the
9 well-being of their investors. No matter how enlightened they
10 may be in community support or in workforce protections, they
11 can't be expected to open profitable markets to competitors,
12 one whit (sic) faster than law and regulation require. You
13 know better than I the multitude of claims on your time, on
14 your attention, on your resources, as well as the PSC's
15 difficulties in getting information and keeping pace with its
16 current docket.

17 Solutions that rely on an omnipotent regulatory
18 police force, rather than sensible structural solutions, will
19 achieve neither effective customer choice nor effective
20 deregulation. If the utility business were less diffused with
21 the public interest, if Florida's pro-competitive policies had
22 not already been widely articulated, if the absence of local
23 exchange competition for most customers, despite clear state
24 and national policies were not so clear, perhaps the claims of
25 unfairness and unnecessary expense regarding structural

1 remedies would have a different ring to them, but Florida is no
2 longer in the first or second year of its effort to further
3 local exchange competition.

4 Customer choice is proceeding at a pace such that a
5 market without a dominant provider is a decade or more away.
6 If this pace is to accelerate meaningfully, structural remedies
7 are going to be necessary. The experience of Pennsylvania
8 shows that this process may be controversial up front, but it
9 has the potential to avert years of wasteful trench warfare
10 down the road. Given the disappointing record of progress on
11 local customer choice to date, it seems likely that postponing
12 this controversy will expand it rather than avoid it; that
13 structural remedies are a step toward successful deregulation,
14 not toward regulation. In short, the decision to undertake
15 structural remedies will be one that you and your successors
16 will one day recall with pride and with gratitude.

17 Thank you.

18 COMMISSIONER DEASON: Any questions? Thank you.

19 MR. BRADFORD: Thank you.

20 MS. SHELDREW: Thank you very much, my name is Judy
21 Sheldrew. I'm a Senior Policy Analyst with the law offices of
22 Scott Hempling, although, I'll hasten to add in front of this
23 body filled almost entirely with lawyers that I am not an
24 attorney.

25 I was a member of the Public Utilities Commission of
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1 Nevada from 1993 through 2000. I chaired the Commission from
2 1997 through 1999. Most of the time on the Commission, I spent
3 my time deeply involved in the development of Nevada's retail
4 electric competition statute. But more relevant for the
5 proceedings today, I presided over the Commission's
6 investigation into retail restructuring. Our responsibility
7 was to determine whether retail competition could be
8 implemented to benefit Nevada.

9 Now, our investigation began much as yours seems to
10 have today, with the recognition that restructuring any kind of
11 utility industry involves numerous practical, technical and
12 legal considerations. And I think that the Commission is to be
13 commended for opening the investigation with this two-day
14 workshop that will give you really a very sound opportunity to
15 see the issues and explore some of them that need to be
16 considered as you continue on with your investigation.

17 Let me make, first of all, an observation. Both the
18 electric investigation in Nevada and the structural separation
19 docket that you have before you really contain a common
20 objective and that objective seems to me to be that you're
21 trying to improve the way that utility systems work as a whole
22 by determining which products can be delivered more efficiently
23 through competitive systems and which products can be delivered
24 more effectively and efficiently through regulation.

25 Now, there are four regulatory methodologies to

1 achieve this objective of more efficient utility systems and
2 these are methodologies that we used in Nevada in trying to
3 determine where we wanted to go with retail electric
4 competition. The first of those methodologies is cost and
5 bundling. That's really the process of assigning costs to
6 services so that consumers pay to the utility the costs of
7 noncompetitive services that they buy from that utility, but
8 they do not pay to the utility costs for services which they
9 buy elsewhere or they do without.

10 The second step is to determine whether a utility
11 service should be made competitive or noncompetitive. And for
12 this step, you use guides such as the desirability of product
13 differentiation, the attractiveness of potential markets, and
14 the potential for sufficient competition to develop in a
15 particular market, taking into account the relevant market for
16 that particular service, the number of competitors that are
17 participating or are likely to enter that market, and the
18 market share of each of the participants and an evaluation of
19 whether the market share for each of those participants is
20 sufficiently small to deter anticompetitive behavior.

21 The third step and one I want to spend a little bit
22 of time on, and certainly the subject of your workshop, is the
23 separation of competitive services from noncompetitive
24 services. If you proceed with an investigation to look further
25 into structural separation, it's going to be very important for

1 you to recognize the significant obstacles to development of
2 local competition that are represented by the unearned
3 advantages that incumbent utilities have, simply because
4 they've been in the market for decades.

5 These advantages include such things as retaining and
6 building customer loyalty, securing and retaining control of
7 bottleneck facilities, conducting internal restructuring before
8 competition officially begins and before other competitors are
9 really able to enter the market or reducing the number of
10 competitors through such things as acquisitions or mergers.

11 Now, if competitive and noncompetitive services are
12 both provided by the incumbent utility, there are opportunities
13 for anticompetitive conduct. These arrangements allow an
14 incumbent utility to, one, shift costs from retail activities
15 to essential facilities cost. For example, the ILEC can
16 undercharge its retail arm for unbundled network elements.
17 Such arrangements allow the incumbent to cross-subsidize its
18 retail activities by allocating costs attributable to retail
19 activities to essential facilities costs.

20 For example, the ILEC can allocate too much of its
21 common costs to unbundled network elements allowing it to price
22 retail services below its own cost. Three, such an arrangement
23 can allow the incumbent to engage in certain retail activities
24 undertaken within the vertically-integrated structure with
25 little fear of regulatory detection. For example, the ILEC can

1 send some of its employees, who are dedicated to retail
2 activities, to new education courses for new retail products
3 and those costs can be borne certainly in the cost of your
4 noncompetitive facilities.

5 Five, such arrangements can allow the incumbent to
6 create additional barriers to competition or enhance
7 preexisting barriers, which increases the chances for success
8 in the competitive market. For example, the ILEC that
9 marketing efforts to increase name recognition is one way that
10 this can be done quite easily.

11 And five, such arrangements can allow the incumbent
12 to discriminate in the provision of services between
13 competitors in its internal retail services arm; for example,
14 the ILEC requires the alternative local exchange carriers
15 companies to seek provisioning of unbundled network elements
16 from operation support systems pursuant to interconnection
17 agreement prices while provisioning its own services internally
18 at a lower implicit price.

19 Now, the challenge to regulators is to determine
20 whether and how the incumbent utility is to be allowed to play
21 two roles. The first is to allow the single entity to perform
22 both monopoly and competitive services. And I would submit to
23 you that under that kind of arrangement you'll have many of the
24 problems I just got done describing.

25 The second is to preclude a single affiliate from

1 performing both noncompetitive and competitive services but
2 allow activities in separate affiliates. And the third option
3 is to permit no mixing of noncompetitive and competitive
4 services in the same corporate family. Nevada chose to allow
5 its incumbent utility's corporate family to engage in the
6 provisioning of noncompetitive and competitive activities
7 through separate affiliates.

8 However, this was only allowed upon a showing that
9 nondiscriminatory access was being provided to the
10 noncompetitive facilities that were needed by other
11 competitors, yet the competitive affiliate would have an
12 arms-length relationship with the distribution company, that
13 the business relationship between the competitive affiliate and
14 the distribution company would not adversely affect the
15 development of effective competition, and the risk of
16 anticompetitive behavior and all the regulatory costs required
17 to prevent such behavior was minimal and the distribution
18 utility, and the affiliate had the burden of proof to
19 demonstrate those before the affiliate was allowed to
20 participate in the market.

21 In approving this structure, we believe that it
22 offered a number of good opportunities for development of the
23 market while allowing the incumbent utility to continue to
24 participate. For example, it would allow the distribution
25 company to focus on its core business of providing

1 nondiscriminatory access to distribution transmission systems,
2 it would preserve those existing economies of scale and scope
3 that can result in lower costs to consumers, and it would make
4 detection of any anticompetitive activities easier for the
5 regulators.

6 The fourth step involved in our process and one that
7 I recommend to you is to consider affiliate codes of conduct.
8 Now, one way to prevent cross-subsidization between incumbent
9 utilities and their competitive affiliate is to establish
10 effective codes of conduct. The purpose of these codes, stated
11 simply and shortly, is to enable regulators to enforce the
12 separation that you have ordered.

13 These codes really generally require that any
14 interactions between the two entities be at arms-length, that
15 there be a demonstration that the affiliate will not gain any
16 unearned advantage as a result of its affiliation, that the
17 regulatory costs of allowing the competitive affiliate will not
18 exceed the benefits to the consumer and that you must establish
19 a basis for the charges between the two entities.

20 Now, I have in my handout a number of requirements
21 that Nevada used in establishing its affiliate code of conducts
22 for its competitive retail affiliate and the distribution
23 company which I'll just touch on briefly here in the interest
24 of time.

25 We attempted to explain what the arms-length

1 relationship was between the two affiliates, so everyone knew
2 up front what the requirements were going to be. We limited
3 the use of certain shared services between the affiliate and
4 the noncompetitive affiliate and restricted the use of shared
5 officers and employees.

6 We also established transfer pricing rules for the
7 transfer of goods and services between the noncompetitive
8 company and its affiliates, and to answer really a question, I
9 think, that Commissioner Deason had a bit earlier, we did
10 prohibit the retail affiliate from having a name that was
11 deceptively similar to the noncompetitive affiliate and also
12 using its logo.

13 Now, we did allow the company to indicate or
14 advertise its affiliation with the distribution company, but
15 they had to do so with a disclaimer, indicating they were not
16 the same company, they weren't subject to the same kinds of
17 regulations and those kinds of things.

18 Now, the extent to which you develop affiliate codes
19 of conduct, I think, really depends really on your market, what
20 you're trying to achieve, the extent of separation that you
21 have between the competitive affiliate and the noncompetitive
22 affiliate, but that is one example of what we think were fairly
23 stringent, yet fair, affiliate codes of conduct that we put
24 into place to try and establish the competitive affiliate
25 entirely separate within the same corporate family as the

1 noncompetitive entity.

2 So, what are the benefits of separation to
3 regulators? Well, the process of separating competitive
4 services and what should be -- separating competitive services
5 from noncompetitive services may seem somewhat complex.
6 However, not separating the services results in additional
7 confusion and increasing disagreements as time goes on as, I
8 think, is evidenced by this proceeding today.

9 Investing in regulatory resources earlier, I think,
10 will save you costs later. The benefits of structural
11 separation to state regulators really can be put into three
12 categories: Stronger competition in local markets, a greater
13 protection to consumers, and improved efficiency in the
14 regulatory process.

15 As far as stronger competition in the local markets,
16 structural separation reduces uncertainty in the marketplace,
17 because it identifies the basis upon which decisions will be
18 made relative to any disagreements or how activities are
19 supposed to be conducted between the retail affiliate and the
20 noncompetitive affiliate. It allows ALECs' and the ILECs'
21 retail affiliate increased flexibility in designing their
22 products to meet the needs of consumers secure in the knowledge
23 they'll be able to acquire interconnection and essential UNEs
24 at a time and place when they need them in order to provide
25 those services.

1 It gives competitors confidence that the state takes
2 competition seriously and sees market power as a problem that
3 must be dealt with in order to have effective competition, and
4 it reduces the costs of market entry to ALECs who, otherwise,
5 would have to invest large sums to litigate issues to get into
6 a particular market.

7 Structural separation provides greater protection to
8 consumers in that it increases the transparency of transactions
9 between the competitive affiliate and the noncompetitive
10 affiliate and you, as regulators, are able to track them and
11 consumers are able to rest assured that these transactions are
12 not resulting in cross-subsidy or cost shifting to them. It
13 reduces the opportunities for anticompetitive conduct in the
14 provisioning of unbundled network elements, and it reduces the
15 opportunities for the ILEC and its retail affiliate to distort
16 prices for basic services, thereby, foreclosing competition and
17 possibly overcharging consumers.

18 And finally, structural separation improves
19 efficiency in the regulatory process. Why? Because it
20 increases public accountability, because of responsibility for
21 identifying and resolving these problems can be lodged with the
22 Commission. It increases the probability that market power
23 problems created by the vertical integration of a utility will
24 be resolved sooner rather than later. It provides the
25 Commission a unique opportunity to gain valuable information

1 about essential unbundled network elements and interconnection
2 issues.

3 And one of the values that I saw out of our process
4 was the information that we gained about how our electric
5 utilities operated, their costs, what percentage of their costs
6 were attributable to various services. It was invaluable. It
7 allows the Commission to focus its energies more directly on
8 services where there is not effective competition which is,
9 after all, what regulators and regulation is all about.

10 It transforms the Commission into a proactive policy
11 setter instead of an after-the-fact enforcer who is continually
12 having to resolve complaints for which there may not be a clear
13 answer and you have to act like Solomon had the baby.

14 And finally, it saves money, because you can get a
15 single set of proceedings behind you and it can address most,
16 if not all, of the problems. So in a very quick scale, those
17 are really what I see as the advantages of your proceeding with
18 your investigation. I want to close by commending you, again,
19 for opening this investigation and encourage you to go much
20 further and evaluate all the various issues thoroughly so that
21 you feel comfortable making the decisions that you think are
22 right, not only for the Florida competitive market, but for
23 Florida consumers. With that, I'll be happy to answer any
24 questions.

25 COMMISSIONER PALECKI: I wanted to ask you, you've

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1 gone into quite a bit of detail about the electric industry in
2 Nevada and how they require separate affiliates for
3 noncompetitive and competitive activities. What has the state
4 of Nevada done in the telecommunications area?

5 MS. SHELDREW: Nevada, as many states, is still
6 struggling with the fabulous experience of dealing with
7 unbundled network elements. It has not yet resolved all of
8 those questions. We did not really have an opportunity to even
9 get into the structural separation question before I left the
10 Commission.

11 However, Nevada actually had a fairly pro-competitive
12 posture, even before passage of the 1996 Telecommunications Act
13 in that omnibus regulations were approved that really allowed
14 the classification of certain services and allowed plans for
15 alternative regulation, price gap regulation, for all incumbent
16 ILECs. But to the extent that we had undertaken, I guess,
17 structural separation, we had not done that. And I'll be
18 honest with you, since probably last year about the middle of
19 the year, the last time I saw any numbers on SBC's numbers, I
20 think, they had 98% of the lines that were still in the
21 marketplace, still assigned to them. So, we obviously, had a
22 long way to go to get anywhere close to local competition in
23 the state of Nevada and telephone services.

24 COMMISSIONER PALECKI: Thank you. Thank you very
25 much.

1 MS. SHELDREW: Thank you.

2 MR. GRAHAM: Good afternoon. My name is Bill Graham.
3 I'm with the McFarlain & Cassedy law firm here in Tallahassee.
4 I practice in the regulatory area. And I'm here to speak
5 briefly, wonderfully briefly, about Item number 5. Indeed, it
6 will probably be the shortest legal presentation I've ever
7 given, so I'm sure you all will enjoy that. It's nearing the
8 end of a long day.

9 I'm able to be brief, because I'm in the wonderful
10 position of having been assigned an item that my opposition has
11 already conceded. The question is whether there are
12 impediments to implementing any remedies other than structural
13 separation? And our position is, indeed, there are no such
14 impediments and that's the position that was adopted earlier
15 this morning by Mr. Lackey.

16 Commissioner Jaber, in response to your question,
17 Mr. Lackey said -- your question, rather, was if we didn't go
18 full borne and adopt a complete structural separation could
19 Florida adopt a code of conduct. And the answer was, yes, you
20 can do a code of conduct. And Mr. Lackey went further,
21 happily, and said that as a matter of law you could require
22 BellSouth to -- and I'm looking at my notes here -- you could
23 require BellSouth to enter into arms-length -- an arms-length
24 transaction between its separate divisions in a functional
25 separation scenario, so indeed, that an alternative remedy,

1 there's no impediment to that. There's always a catch, though.

2 However, we advocate for full and complete structural
3 separation, as you've heard several times today. We suggest
4 that you should utilize and implement your jurisdiction in its
5 broadest sense. By doing that, you will address the core
6 problem that is present in Florida's telecom market, and that
7 is the inherent conflict that exists when BellSouth is in both
8 the retail and the wholesale markets.

9 And it's our position that only full and complete
10 structural separation will get to that core problem. Any
11 alternative remedy is not going to get us to the full and fair
12 open competition that we are all seeking. And that's it.
13 Unless there's any question.

14 COMMISSIONER DEASON: That was a superb job.

15 MR. GRAHAM: Thank you very much.

16 COMMISSIONER DEASON: Any questions? You did so
17 well, there are even no questions.

18 MR. GRAHAM: It's my pleasure. Thank you.

19 COMMISSIONER DEASON: Thank you.

20 MR. LAMOUREUX: I get the wonderful task of saying
21 goodbye and I want to thank the Commission, again, for the
22 opportunity for the workshop and for us to present. And I'm
23 just going to say very briefly there was one last issue. It
24 was Issue Number 6 which is what impacts would this have on
25 BellSouth's obligations, either under the Act of Florida

1 statutes? And this will probably be the only time you ever
2 hear me stand up and say this before you, but partially the
3 answer is I don't know.

4 This is the beginning stages of this discussion. You
5 heard several witnesses say that -- several presenters say that
6 in this workshop so far we have not yet gotten to the stage
7 where we have scoured all of the different provisions of the
8 Florida statutes and all the nuances under the Act, so we don't
9 know the full spectrum. And to be honest, we don't know what
10 form structural separation might take. You heard different
11 discussions about what it could look like at the end of the
12 day.

13 Without knowing exactly what it would look like, it's
14 not really possible right now to talk about what impact it
15 would have on BellSouth's obligations under the Act or Florida
16 statutes, so it's not possible to give you a comprehensive
17 answer which is what I want to say is that that is another
18 reason, again, why we want to continue this discussion, why we
19 want to move on beyond today to continue to talk about what
20 would, at the end of the day, the impact be on their
21 obligations under all the statutes in the Florida statutes and
22 under the Act.

23 I just want to say, very briefly though, clearly, the
24 basic obligations under the Act, the federal act, would not go
25 away, even if there was structural separation. The point of

1 the Act or at least 251 and 252 and, to some respect, 271, is
2 to ensure that BellSouth, in whatever corporate form it may
3 exist, provides the things that are necessary to allow CLECs to
4 gain access to the bottleneck facilities to the network that
5 the CLECs need to be able to compete in marketplace. Those
6 obligations would still be around and would still exist.

7 How they would apply to whatever the corporate form
8 would look like at the end of a structural separation process,
9 I can't tell you exactly, because I don't know what that form
10 would look like. We've heard different proposals, but the core
11 of those obligations would still be around and would still
12 apply. And, I think, importantly they would still -- it would
13 still be necessary for this Commission to enforce those
14 provisions under the federal Act, even if it's true that if
15 structural separation occurred and somehow that divested the
16 Commission of its jurisdiction of the network company
17 provisions of the Act would still apply, and this Commission
18 would still have an obligation to enforce those provisions of
19 the Act, even as to the network company.

20 And I just wanted to conclude by making sure that we
21 all understood that, that regardless of what happens under
22 state statutes, if this corporate forum changes in some form,
23 the provisions of the Act would still apply and it would still
24 be the obligation of this Commission to enforce those
25 provisions of the Act. With that, I think, I either had the

1 final shortest or the second shortest presentation. And again,
2 I wanted to thank you for the ability to have this discussion,
3 and I do hope that we do have the opportunity to continue
4 discussion further down the road.

5 Thank you.

6 COMMISSIONER DEASON: Thank you.

7 MS. LOGUE: Commissioners, our next presentation will
8 be by Mr. Russell Frisby who is the president of the
9 Competitive Telecommunications Association.

10 MR. FRISBY: Great. No technical difficulties.

11 For the record, my name is H. Russell Frisby Jr., and
12 I am president of the Competitive Telecommunications
13 Association. Commissioners, I would like to thank you for the
14 opportunity to testify today on behalf of Comptel and our
15 approximately 300 members. We have submitted a copy of the
16 presentation for the record as well as a white paper entitled,
17 "Structural Incentives: The simpler, more efficient path to
18 local competition."

19 I would like to reiterate what has been said earlier.
20 What you're doing here today is incredibly, incredibly
21 important. The question of the use of structural incentives,
22 as a more efficient path to local competition, is a crucial
23 one. We are entering an important national debate on this
24 issue and a lot of that debate, quite frankly, will take place
25 in Florida because of the fact that Florida has historically

1 led the way on telecommunications issues.

2 The time has come for whether you call it structural
3 separation or as we call it structural incentives. I think,
4 former Chairman Kennard, immediately after leaving the
5 Commission, was asked what he thought about structural
6 separation, and he said he thought it was an eloquent solution.
7 I just wish he had said it while he was still on the bench.

8 Earlier this morning, counsel for BellSouth made this
9 appear that this was sort of an AT&T versus the RBOC issue. He
10 said AT&T can't afford to lose this. The debate we're talking
11 about today is not about AT&T winning or losing. It's about
12 whether consumers win or lose, whether consumers have
13 competition. That's what this is about. And it's not just
14 about AT&T. It's about the whole competitive industry.

15 Next slide. Why are we here? What's Comptel.
16 Comptel, quite frankly, is the world's oldest association
17 representing the competitive telecommunications industry.
18 We're founded in 1981 representing small long-distance
19 carriers; however, we've evolved and our members now provide
20 local, domestic, international long-distance service, voice,
21 Internet data, you name it, we do it. In fact, probably a
22 majority of our members now are CLECs. However, even given the
23 diversity of our members, our competitive providers are
24 dependent one way or another upon the access to the local mile.
25 That last mile monopoly frustrates them. That's why we're

1 here.

2 Next. Comptel aggressively advocates pro-competitive
3 open entry policies. Competition is vital to the U.S. economy,
4 it's vital to Florida's economy; I note, I think, Florida just
5 set up a network access point, and it's critical to American
6 consumers.

7 We can't get around the fact -- you can't ignore the
8 fact that the RBOCs still have a de facto monopoly control over
9 essential bottleneck facilities. Now, we know that affects
10 prices, we know that a monopolist, by definition, monopolies
11 are inefficient and that monopolies price above economic cost.
12 And going to Commissioner Jaber's question, whether it's Telric
13 or whatever forward-looking price, there is a profit built into
14 that.

15 So, to the extent that the monopolists are saying,
16 well, Telric is somehow unfair, what it means is that Telric
17 can't -- will prevent them from getting their monopoly rents or
18 monopoly profits, not that Telric doesn't include a profit,
19 because it does.

20 But the other issue is the fact that monopolies don't
21 innovate. Monopolies -- I think, some economists call it a
22 replacement effect. And what that means is that monopolies
23 look around and say, well, if we innovate, this is going to
24 affect our pre-monopoly profit-- our monopoly profits, this is
25 going to affect our monopoly investment. We won't do it.

1 That's why broadband really came about only in response to
2 competitive efforts.

3 So, what we have done for the year 2000 is set up
4 five objectives, and they're all related. The first two, local
5 access and competitive broadband access, address the
6 fundamental issue of assuring that competitors have access to
7 their customers, have access to the facilities that they need
8 to reach their customers.

9 Related to this is the compensation issue, making
10 sure that competitors are able to lease prices at economic
11 costs and at the same time get competition for -- get fair
12 compensation for the services they provide.

13 Now, international market access, and the
14 international issue has been raised earlier, that's important
15 because you in Florida know that we live in a global society,
16 and everything we do, we do in a fish bowl. And we are trying
17 through the WTO and other methods to open up international
18 markets.

19 Now, I spent a lot of time meeting with foreign
20 delegations, and increasingly, European, Asian, and Latin
21 American delegations are all saying why should we open up our
22 markets? Because it seems as if the U.S. is moving back to a
23 monopoly. So, what you do here, what we do in Washington is
24 very critical. And that's why we believe that the answer lies
25 with structural incentives.

1 We've had five years of this. If you had asked me, I
2 guess, five years ago or six years ago, when I was chairman of
3 the Maryland Commission, whether I thought structural
4 separation was the way to go, I would have probably said no,
5 because I thought regulation would work, I thought that the '96
6 Act would work, but clearly it's not.

7 Clearly, we have to do something else because of the
8 fact that there's a simple truism. I was trying to figure out
9 the part of Shakespeare that Joe was referring to, but I
10 couldn't. But the bottom line is that monopolists don't give
11 up their monopoly, pure and simple, they don't give up their
12 monopoly, and so we have to look at incentives.

13 Now, in 1996, Congress did consider structural
14 separation, but it said that it wasn't necessary to go to
15 structural separation, because the carrot and stick approach of
16 271 had worked. It hasn't. And that's why we're here today.
17 We're here today to urge the Commission to recommend a
18 corporate structure -- to adopt a corporate structure that
19 realigns the incumbent's commercial incentives to achieve
20 rather than frustrate the essential goal of competition. And
21 to do that, it's important that the ILECs' retail affiliate
22 compete, as with any competitive local exchange carrier, with
23 sufficient separation from its incumbent parent to ensure
24 independent decisionmaking. So, when you read our paper, you
25 will see that our recommendation is the same as the FCCA in

1 terms of how structural separation should be implemented.

2 Now, we have not -- we have been struggling with this
3 for a long time, actually for over a year. And we began
4 working on a white paper last summer, and we unveiled our
5 position last November at NARUC, and we've been involved in
6 Pennsylvania, we've been involved in proceedings before the
7 Alabama, Indiana, Georgia, Tennessee Commissions. We've been
8 involved in legislation in Illinois, Maryland, Minnesota, on
9 Capitol Hill.

10 A couple of observations. With regard to Capitol
11 Hill, Congressman Heather Wilson did actually introduce a
12 structural separation bill, but she withdrew it because
13 Chairman Tauzin ruled that it was non german. So, and as been
14 mentioned, Senator Hollings has raised the discussion, so there
15 is discussion on Capitol Hill.

16 Now, with regard to Maryland, it's been mentioned a
17 couple of times, I was not on the Commission in 1994, when the
18 Maryland decision that was mentioned was handed down, but I
19 would like to make a couple of observations based on my
20 understanding.

21 First of all, 1994 was seven years ago. Secondly, at
22 that point the Commission and the legislature were discussing a
23 much broader statute for the Maryland Commission to give it
24 broader regulatory authority. That statute was actually
25 adopted. And the thought, quite frankly, in '94, '95, '96, was

1 that the Commission had sufficient regulatory authority and the
2 competition would move forward on its own. I think, if you
3 look at the experience in Maryland it's been very disappointing
4 since then.

5 Also, I note that since that point Maryland has been
6 very active with regard to gas and electricity restructuring,
7 so I don't think one can read too much into the 1994 Maryland
8 decision. Secondly, with regard to the whole question of the
9 Maryland legislature, quite frankly, Maryland looked north and
10 it saw Verizon running ads by Darth Vader, it saw unions coming
11 out, and the Maryland legislature decided it didn't want the
12 political fight, it was going to be too contentious, so quite
13 frankly, it put it into summer study, and it's still currently
14 in summer study. So, I think it's not accurate to say it was
15 actually rejected.

16 Next slide. Why structural incentives? We support
17 -- our membership supports the use of structural incentives as
18 a local market opening tool. This is not about keeping the
19 RBOCs out of long-distance. Long distance is extremely
20 competitive. There are over 600 companies in long distance
21 now, the margins are dropping. This is not about that. The
22 issue is opening up the local markets, and it's not about AT&T,
23 it's not even about long-distance carriers.

24 I do a lot of traveling throughout the country
25 talking to my smaller members because, quite frankly, they

1 can't come to Washington. Last week I was in Houston, Texas
2 visiting a small CLEC. Only thing there the management wanted
3 to talk about was structural separation. They're having so
4 many provisioning problems that they are saying what are you
5 going to do for me in structural separation? How can we move
6 that forward? Had conversations in Rhode Island, I've had
7 conversations with my members, small CLEC members, all over the
8 country talking about structural separation and how they need
9 it to survive.

10 What kind of structural separation or what do we see
11 the advantages? First, it minimizes or eliminates the
12 inevitable conflict that results from an RBOC's dual competitor
13 supplier role. Secondly, it creates a level playing field, and
14 third it reduces the need for regulation.

15 Now, any Commission in this situation is always in a
16 tough situation. You've got a complex choice. The complex
17 choice is do you proceed with on the regulatory road attempting
18 to open the market to force nondiscriminatory access? On that
19 road, however, you do have to overcome the natural incentive
20 that I mentioned about the monopolist not open the monopoly.

21 At the same time, there's a question of Commission
22 resources. Quite frankly, I used to envy the Florida
23 Commission, because you had a lot more people than we had. We
24 had five people in our version of the common carrier bureau.
25 There were only so many bodies I had to send into offices to

1 see whether there was actually collocation or so many
2 economists I could get involved in a rate case or in other
3 cases such like that.

4 So, there is a pain and a cost to continuing on, and
5 it puts the -- on the regulatory road. It also puts the
6 Commission in a situation of increasingly getting involved in
7 issues which are extremely complex and, to some extent, beyond
8 your can and beyond the can of the Staff.

9 On the other hand, we think that structural
10 incentives create a structure where you don't have that much
11 regulation, you don't -- there is a transition, but after the
12 transition period, the issues are much more simple, the issues
13 -- the violations are more straightforward, and it gets the
14 Commission out of a lot of incredibly difficult issues. And
15 because it does incent the -- it incents the ILEC to move
16 forward to an environment where its commercial success depends
17 on its ability to offer an efficient system.

18 Now, we talk about the substantial resources that are
19 involved in the process, but 271 is not the answer. I don't
20 have to tell you about the time and money involved in the
21 process. From the perspective of my members, many of them
22 can't afford to participate meaningfully in 271 processes, and
23 the advantage of struc-- one of the advantages of structural
24 separation in terms of reduced regulation is that it gives you
25 things, like, such as instant interLATA data relief. You don't

1 have to worry about questions about does the RBOC have the
2 incentive to invest. The wholesale company will have the
3 incentive to invest, because it has the incentive to grow its
4 network to increase volume in use by all commerce.

5 At the time, the retail company has the incentive to
6 offer better and cheaper services. Customers benefit. The 271
7 post-- and we've had a problem with 271 post entry, a
8 significant problem with 271 post entry, because for many of
9 the RBOCs payments or fines are simply the cost of doing
10 business. Here you see New York, Verizon has paid maximum
11 penalty for DSL service, we've had. We have a tremendous
12 problem with special access.

13 Next slide. On June 19th, BellSouth paid \$4.5
14 million in fines in Georgia, and BellSouth has paid about 20
15 million to date. SBC has paid more than \$35 million in
16 penalties for poor wholesale performance since December 2000.
17 Now, it's to the point some of my Texas members get checks and
18 they're not sure what they're getting checks for. They know
19 that SBC has fouled up for some reason but the billing system
20 -- the performance measurement systems are so complicated and
21 they get all these boxes of bills or whatever, they can't make
22 hyde or -- head or tails out of this. I mean, this is what
23 we've come to; that in many instances, the RBOCs find it's much
24 more cost efficient for them just to write a check.

25 You know, in the Washington debate there's a lot of

1 debate now about enforcement. The real debate is whether the
2 cap is going to be raised from \$10 million to \$25 million to
3 \$50 million. And, you know, I think, it's time to begin to
4 look for other solutions because the inevitable conflict that
5 results from an RBOC's dual role as competitor supplier still
6 exists after 271.

7 Next slide. Wanted to talk about Pennsylvania and
8 also about functional separation. The Pennsylvania Utility
9 Commission's functional structural approach was a step in the
10 right direction, but we submit that it does fall short. First,
11 only if the end services were offered through a separate
12 affiliate, not all retail services, we believe that if you're
13 looking at functional separation, all retail services should be
14 offered along the lines of the energy situation in which you
15 have the transmission company and the retail -- and, you know,
16 your distribution, your transmission companies.

17 The second problem is that the affiliate is
18 wholly-owned by the ILEC. I don't know how you get around that
19 in a functional separation situation. The problem is that
20 since the entity is judged by the consolidated returns there is
21 still the incentive to cross-subsidize and engage in any
22 competitive activity.

23 The third problem is that the affiliate can joint
24 market with the ILEC and receives operations, installation, and
25 maintenance services from the ILEC. We believe that this is an

1 absolute no-no, that if -- a joint marketing is fatal, because
2 it just incents cheating. And, again, it depends on the code
3 of conduct. I mean, some code of conducts are stronger than
4 others. The Pennsylvania code of conduct is still being
5 developed, but I would urge the Commission to consider, if you
6 are considering functional separation, to consider things such
7 as functional separate personnel and management.

8 I remember one time when I was on the bench in
9 Maryland, we were looking at the gas affiliate, and testimony
10 came out that the head of the competitor for the affiliate was
11 the same person who was heading up the gas operation for BGE,
12 and we asked him, well, how can you do both? And he said,
13 well, when I'm talking about competitive operations I turn off
14 my regulated part in my head, and when I'm talking about
15 regulated side, I turn off the competitive side and we said,
16 no, that's not going to work, you really need separate
17 personnel.

18 Also, even separate buildings. There was another
19 situation, same case, and it turned out that one of the retail
20 people, competitive people, had gotten commercially sensitive
21 information because he happened to be in the bathroom at the
22 right time. You know, this seems odd, but it was a situation
23 he had a couple million dollar advantage because he was in the
24 same building, so things like that would seem minor, but that's
25 very important.

1 Also, management bonuses and salary. They have to be
2 dependent upon the performance of the actual entity as opposed
3 to the performance of the overall entity, so the wholesale
4 people have to be paid, their bonuses have to be on how that
5 entity works. The retail people have to be -- their bonuses,
6 incentives have to be based on how the retail entity works,
7 because you've got to incent them to make sure that their own
8 individual portion works as opposed to their normal incentive,
9 which would be to promote the entire operation.

10 Next. The PUC'S, Pennsylvania public Utility
11 Commission's approach, has is actually created more, not less,
12 regulation. In fact, there are currently seven proceedings,
13 there's a proceeding on the permanent code of conduct, a
14 workshop on DSLAMS and remote terminals, there's a technical
15 trial on electronic loop provisioning, there's a collaborative
16 on DSL over digital loop, there's a line-splitting
17 collaborative, there's performance measures, there's UNE rate
18 adjustments.

19 So, it's unclear that adopting a functional versus
20 the structural approach will create any less regulation or
21 they're not SPDRS. One other point, are there costs involved
22 in structural separation, yes? Do we know what all the costs
23 are? No. But I would point out that if you go to the
24 Pennsylvania order at Footnote 17 on Page 23 it states that
25 "we, unequivocally, repudiate the asserted \$1 billion estimate

1 of Verizon is wholly lacking in evidentiary support. We had
2 hoped to be able to identify some of the costs in the
3 Pennsylvania proceeding, but Verizon, as is on the record, did
4 not submit the necessary data.

5 But I will say that I've got enough gray hairs to
6 have been around the track before on this. And in 1984, AT&T
7 was saying, well, you know, divestiture, you're going to have
8 billions and billions of dollars in costs, the network's going
9 to fail, people aren't going to get service, et cetera, so
10 we've heard this before, and it's a thing you always hear, but
11 I think it's a weighing and balancing process, and that's why
12 we urge you to move forward with this process, because the
13 critical national issues, there's a need to develop a record,
14 this is a perfect place to develop a record.

15 And in conclusion, structural incentives have merit.
16 Every great civilization has highways. If you go back to
17 ancient Venetia, their highway was the sea. All the roads lead
18 to Rome. Quite frankly, today all telecommunications roads
19 lead to the U.S. That's our highway of the 21st century and,
20 increasingly, a lot of those roads are coming through Florida.

21 And what we are talking about is keeping those roads
22 open, making sure that consumers get the true benefits. And
23 the only way that can happen is by creating a new incentive
24 structure that turns the creativity of the incumbent's
25 management toward the achievement of a competitive local

1 marketplace, and we think the answer is structural separation.

2 Mr. Chairman, Commissioners, thank you very much.

3 Are there any questions?

4 COMMISSIONER JABER: Mr. Frisby, I have just a
5 general policy dilemma that will weigh heavily on my mind, and
6 as a former commissioner, I think, it's one that you would
7 appreciate, which is making sure that the focus and the dispute
8 doesn't shift from the 14-point checklist and OSS testing to
9 BellSouth has not split up, they have not split up fast enough,
10 they haven't split up the way you said, and that all results in
11 delay. And delay, the theme from all of the competitive
12 providers is you don't want delay, so how do I -- I hear what
13 you're saying. Structural separation to me, any way I look at
14 it, so far sounds like delay, certainly the potential for
15 delay.

16 MR. FRISBY: You're right. There is no way to get
17 around that. And if you really look at what Chairman Powell
18 said, his concerns were the delay that would be caused. Our
19 real concern is that if you look at the slide about post-271,
20 that even after you go through the 271 process, we're still
21 going to be having the problems. You're going to be in a
22 neverending situation.

23 Would we prefer that we could wave a magic wand,
24 271's implemented, and everybody's happy, there are no
25 problems? Yes, but that's not going to happen. So, we're

1 forced to say, yes, there may be some delay but in the long run
2 with structural separation once it's done right, it's done,
3 because at that point the wholesale company's incentive is to
4 open the market to everyone; whereas, you know, you're going to
5 be -- you're going to continue the death by a thousand cuts.

6 COMMISSIONER JABER: So, your members have thought
7 through the time element and have thought through how many
8 companies may not be able to enter into the market while
9 BellSouth is undoing, redoing, revamping, if we agree that
10 structural separation is the way to go?

11 MR. FRISBY: I think, with regard -- we're not
12 certain -- if you ask me today what's the time limit, I don't
13 know, this is why we have proceedings like this, but the
14 dilemma we have is that if we continue with the same structure,
15 even after 271 approval, we're dying, we're getting killed.

16 COMMISSIONER JABER: Okay. Would your members be
17 amenable to -- and I don't mean to make light of the situation.
18 As you know, this is a critical --

19 MR. FRISBY: Right.

20 COMMISSIONER JABER: -- situation in my mind with
21 respect to the level of competition, so I don't mean to compare
22 it to how I communicate with my children, but just to use my
23 children as an example --

24 MR. FRISBY: I do it all right the time, so don't
25 worry.

1 COMMISSIONER JABER: Okay. If I said to my children
2 you have got to do this, and you have to do it this way, I will
3 hear for at least a good few hours why they can't possibly do
4 it the way I want them to do it. And I find myself, if I take
5 the approach of the carrot and the stick and the punishment,
6 they'll do it, but they're going to be completely bitter and
7 they'll be completely unproductive for anything else that I
8 might ask of them. But if I figure out what each of them
9 really might want, I might get a better result, and we can all
10 move on.

11 So, if 271 and entry into long distance isn't working
12 and the Act isn't working in that regard, then what might work
13 at a state level? What is it that an ILEC might want? Might
14 it be, for example, designation of certain parts of Florida?
15 Might it -- you know, what --

16 MR. FRISBY: See, and here's the dilemma: I remember
17 being in a panel Amelia Island with, I think -- no, not Amelia,
18 no, it was here in Tallahassee a year ago, on a panel, and Ivan
19 Seidenberg was on from Verizon and Roscoe Young was on it.
20 After Roscoe and I made a fairly forward presentation,
21 Mr. Seidenberg says, "What, do you want use my networks?" And
22 here's the fundamental dilemma we have, that Bell's view of
23 competition is that there should be one wireline company, one
24 cable company, one wireless company or a couple wireless
25 companies and maybe one satellite company, but there shouldn't

1 be real competition in the wireline network, because their only
2 competition they're willing to tolerate is totally
3 facilities-based competition.

4 And the problem with that is that, as Mr. Gillan
5 testified earlier, on a purely facilities-based basis you can
6 only reach very few customers, but for most small and
7 medium-sized customers, whether it's business or residential,
8 you need those connections. So, I'm not sure -- the dilemma
9 we've had, and I've had this discussion on Capitol Hill, they
10 say, well, what are you guys willing to settle for? The bells
11 are pushing, well, you can't connect to our network. I mean,
12 all we're asking for is implementation to the Act, let us
13 connect to the network on an economic cost basis, pure and
14 simple. We believe there are essential facilities. I'm not
15 sure what we can give, aside from agreeing to not take
16 connections to the networks, and we can't do that, because then
17 we don't have a business. So, this is the dilemma we have and
18 this is why, quite frankly, after discussions this summer we
19 decided to move towards structural separation, because aside
20 from changing the rules of the game, the incentives, we don't
21 know what else to do.

22 CHAIRMAN JACOBS: The -- what was it? I saw it a
23 minute ago in your paper here. The -- you agree somewhat, I
24 see, with Mr. Gillan's kind of middle ground approach --

25 MR. FRISBY: Yeah. And so we can be clear on the

1 record, Mr. Gillan is also a consultant for Comptel and was
2 involved in the preparation of the paper.

3 CHAIRMAN JACOBS: Okay. And are you aware if there
4 are other emerging models or trends out there other than that
5 for separation -- I mean for structural remedies?

6 MR. FRISBY: We are -- we're on the cutting-edge --
7 the beginning of the discussion, so no, my sense is right now
8 the three models are -- well, there are several models,
9 business as usual, functional separation, sort of the Gillan
10 model, and sort of the AT&T divestiture model, but quite
11 frankly, we're also looking toward -- to the energy markets
12 because of the fact that -- in the gas market in particular and
13 to a lesser extent in electricity market Commissions are
14 dealing with structural separation issues and are beginning to
15 look there for other alternatives.

16 CHAIRMAN JACOBS: What guidance should we get from
17 the idea that ILECs don't participate in the other ILECs'
18 territory? Is there any guidance to be gotten from that?

19 MR. FRISBY: Well, you know, I've gotten in trouble
20 for saying that the ILECs have no intention of competing with
21 each other. We -- I -- you can take -- you can read several
22 things out of it. You can cynically read that they have no
23 intention of competing against each other; in essence, they've
24 carved up the country in a cartel. I don't know if you've seen
25 our Voices for Choices ads that we run, but we have four men

1 sitting around the table cutting up a Thanksgiving Turkey, and
2 that's our view of the RBOCs. But you could also read that the
3 RBOCs are -- that it is difficult because of the incentives we
4 talked about and all of the provisioning and other problems and
5 that the RBOCs have made it -- they have two choices. They can
6 either fight it out with their fellow RBOCs or just not get
7 into the market.

8 And our belief is that they have decided not to fight
9 it out, because it would be too embarrassing to go public with
10 some of these disputes, but I think it is telling about the
11 problem. The -- at a minimum, it's telling about the severe
12 nature of the problems that even the RBOCs can't go into the
13 other -- or won't go into the other markets.

14 CHAIRMAN JACOBS: Thank you.

15 MR. FRISBY: Yes, Commissioner.

16 COMMISSIONER PALECKI: Do you expect to see anything
17 in regard to federal legislation in the area of structural
18 separation? And if not, why not?

19 MR. FRISBY: I don't know. If you'd asked me this
20 question before Senator Jeffords switched, I would say I don't
21 expect anything, but Senator Hollings has -- Senator Hollings
22 has a track record of introducing legislation. He's very
23 committed to structural separation. We may see something in
24 the senate, I'm not certain.

25 COMMISSIONER PALECKI: Because this is a national

1 issue; is that not correct?

2 MR. FRISBY: Yes.

3 COMMISSIONER PALECKI: This is not just a Florida
4 issue. I think, we can see that just from all the other states
5 that currently are -- either have addressed the issue or are
6 addressing it.

7 MR. FRISBY: I agree wholeheartedly. My sense is
8 that this may go the way of the electricity industry in which
9 you had a number of states moving forward, and then the federal
10 government caught up or is still in the process of trying to
11 catch up. And if you look at what happened in the '96 Act, I
12 think, something like 45% of the states whose population
13 represented 45% of the nation had already adopted
14 pro-competitive legislation prior to the passage of the '96
15 Act, so both in telecommunications and in electricity there's a
16 history of states acting first and then having the feds catch
17 up.

18 Thank you very much, Mr. Chairman, Commissioners.

19 CHAIRMAN JACOBS: Thank you.

20 MS. LOGUE: Mr. Chairman, Commissioners, our next
21 presenter will be Mr. Rodney Page of Access Integrated
22 Networks.

23 MR. PAGE: My name is Rodney Page, and I'm vice
24 president of Marketing and Strategic Development for Access
25 Integrated Networks, and we're in Macon, Georgia. And my

1 delivery today will be a little more formal than usual, because
2 it's very, very important that I communicate some very critical
3 points in the very short time that I have.

4 Access is an ALEC utilizing the UNE-P platform in
5 serving small business customers in nine southeastern states.
6 We provide approximately 58,000 lines with over 3,000 of those
7 located in over 50 cities and towns in Florida today. And our
8 plans include a major expansion of our sales and activities in
9 Florida during the remainder of the year.

10 First, I want to express my thanks to the Florida
11 Commission for providing this forum for input. Small companies
12 like Access sincerely appreciate the opportunity to discuss our
13 relevant issues, and I will endeavor to discuss the issues and
14 perspectives that, I think, will be useful to you, the
15 Commission, in your deliberations.

16 My goal today is to provide a small entrepreneurial
17 company's views on the issues of structural separation as well
18 as the personal insights of the management team, including
19 myself. To provide a frame of reference about the evolution --
20 excuse me, to provide a frame of reference for my comments, it
21 is necessary to share some thoughts about the evolution of our
22 company's regulatory strategy; that is, to answer the question
23 why am I here today.

24 Our company was founded by a former BellSouth
25 employee in 1996 and, in fact, three of the senior executives

1 at Access, a former BellSouth employees, including myself. The
2 company was founded around our president's kitchen table and
3 even before we became certified in our first state in 1997.
4 The company had a vision as to what it wanted to be and how it
5 perceived itself, particularly, as it related to its
6 relationship with BellSouth.

7 It was our sincere desire to become a distribution
8 channel for BellSouth's products, a distribution channel that
9 would be valued by BellSouth as a credible, ethical, and
10 effective business partner. We saw ourselves as partnering
11 with BellSouth, working with them to both companies' mutual
12 benefit, and we actually viewed ourselves as a company that
13 BellSouth would view with pride as a model of how wholesale
14 third-party distribution could work.

15 When we shared these aspirations several years ago
16 with other ALECs, potential investors, and our lawyers, our
17 vision was scorned, ridiculed and generally written off as at
18 best naive and more often than not, completely foolhardy, but
19 our cooperative vision persisted mainly because it represented
20 what we desired our relationship with BellSouth to be.

21 However, we have reluctantly come to the conclusion
22 that the nature of the relationship is viewed differently by
23 BellSouth, much, much differently. With our enlightened
24 awareness we initiated our first formal regulatory
25 interventions several months ago. Until that time, we had

1 never been before any regulatory body to air our grievances.

2 We always thought that the issues and problems,
3 though major and critical to our survival, could be resolved
4 outside the arena of attorneys and regulators. I'm here today
5 because we, the management team of the company, finally
6 recognize the inherent inability of BellSouth, with its current
7 structure, to meet the lost and perhaps naive expectations we
8 had of them in performing as a strategic supplier.

9 That recognition, though long and coming, became
10 crystal clear when we recognized that our wholesale supplier,
11 BellSouth, really didn't view us as a valued customer, much
12 less as a strategic partner. And we recognize that BellSouth
13 had no interest in helping us distribute their products and
14 retain traffic on their network. And we recognized that
15 BellSouth provided a minimum of support, just enough to satisfy
16 the regulators. And we recognized that BellSouth had convinced
17 itself that the retail distribution channels were more
18 profitable than their wholesale arm, and very much related,
19 they believed they were forced to provide their wholesale
20 products at prices that were below their margin objectives.

21 And finally, we recognized that when it came to
22 internal political power within BellSouth, the retail
23 organization overwhelmingly dominates the wholesale function.
24 So, the first message I want to deliver today, once we
25 recognized all these factors, it became glaringly apparent that

1 our efforts to develop a real world wholesale or distributor
2 relationship with BellSouth were doomed to failure.

3 My remaining comments address the bottom line of the
4 structural separation issue as viewed by a company whose reason
5 for existence is to provide value to its shareholders by
6 delivering cost-effective local service alternatives to small
7 business customers in underserved markets. That is our sole
8 agenda. We have no others.

9 BellSouth is a company whose strategic business
10 interests lie in supporting its retail channels, channels that
11 compete directly with us. That fact, by its very nature, is
12 strategically threatening to a company like Access.

13 Recommending structural separation of BellSouth's
14 wholesale and retail units is not a political or regulatory
15 gambit for Access. We view it as the only realistic course of
16 action to reorganize an inhalantly illogical corporate
17 structure, a structure that flies in the face of common sense
18 management and marketing theories and practice.

19 I reached that conclusion by asking several simple
20 questions that, when answered, shed light on the fundamental
21 business drivers and power bases within BellSouth. First, who
22 pays the bills? This rhetorical question highlights the
23 influence BellSouth's retail distribution channels exercise
24 over its corporate policy.

25 The local service revenue streams of its retail

1 channels dwarf those of equivalent revenues from its wholesale
2 division. Therefore, if one focuses on the realities of
3 corporate finance and politics, the major providers of revenue
4 in any company call the tune and BellSouth's retail channels
5 not only call the tune, they own the fiddler.

6 Who makes the profits? BellSouth constantly claims
7 it is being forced to sell its wholesale products at prices
8 below what it should be able to. According to them, many of
9 their wholesale products are provided at prices that do not
10 achieve BellSouth's gross margin objectives. And presumably,
11 BellSouth's retail channels do achieve such margin objectives.

12 Which channel within BellSouth would dominate, the
13 retail channel that is making money or the wholesale channel
14 that is allegedly losing money? I think, the answer is very
15 obvious.

16 Who calls the shots? BellSouth is currently putting
17 forth a Herculean effort to achieve a critical strategic
18 imperative, perhaps the most important since its creation in
19 1984 and that is gaining entry into the end region
20 long-distance business. That topic is not an issue for
21 discussion today, however, with such a critical goal before
22 them BellSouth's retail channels initiated widespread
23 promotional programs that led to several allegations of
24 misconduct.

25 From a BellSouth perspective, did the perceived

1 benefits of the retail channels win-back efforts trump the
2 potential complications those efforts might create for gaining
3 approval for long distance? The answer must have been yes in
4 the mind of BellSouth's retail channels, because the win-back
5 programs were implemented very aggressively.

6 Where's the common sense? Our company experienced a
7 situation that provides an extremely telling insight into
8 BellSouth's internal wholesale retail power balance. Access
9 was provided a letter by BellSouth Interconnection Services,
10 the wholesale division, stating BellSouth's general support of
11 the wholesale business and reiterating its commitment to
12 provide quality service to end users served by its wholesale
13 customers.

14 Our use of the letter to confirm our relationship
15 with BellSouth, the very purpose for which the letter was
16 written, has been challenged by BellSouth's attorneys, but not
17 attorneys from BellSouth Interconnection Services, I might add.
18 This issue has escalated over the months climaxing with the
19 following demands from BellSouth's attorneys:

20 They demand that Access sales agents not mention the
21 word BellSouth, literally. We do not compromise the use of
22 BellSouth's name, because Access brands all its products under
23 its own name, but we do. And the normal explanation of how we
24 provision local service refer to BellSouth as our wholesale
25 supplier or underlying carrier.

1 Apparently, BellSouth does not want to be associated
2 by name with its wholesale customers. We do wonder how
3 BellSouth proposes to hide that fact when technicians with
4 BellSouth shirts arrive on the customer's premises in BellSouth
5 trucks. I suppose BellSouth hasn't seen the entail and side
6 advertisements where that company is proud to associate itself
7 with firms that use its products, that BellSouth objects to any
8 reference of the use of its network by our company. Who's
9 objecting, BellSouth's retail channels?

10 To continue, the attorneys demand that Access not
11 distribute copies of a joint press release issued by BellSouth
12 and Access announcing the signing of a new interconnection
13 agreement. Since the joint release was between Access and
14 BellSouth Interconnection Services, I must presume that
15 BellSouth's retail channels objected.

16 And to conclude this ridiculous saga, their lawyers
17 demand that Access not refer prospects to a web site that
18 contains the aforementioned press release. The press release
19 is located on BellSouth Interconnection Services' own web site.
20 I suppose BellSouth's retail channels must have objected.

21 My second message of the day: The interest of
22 BellSouth's retail channels clearly dominate the policymaking
23 of the corporation. The emotional involvement and frustration
24 that may be apparent in my comments are not contrived or
25 manufactured for the purposes of presentation to this

1 Commission. Since our 80 employees participate in a stock
2 option plan, they have a considerable amount of their future
3 net worth riding on the success of our company, and senior
4 management is also responsible for those 80 employees'
5 livelihood. Therefore, to us, structural separation is not
6 some sort of abstract concept to be debated like the origin of
7 the universe in a college dormitory room where the outcome is
8 meaningless but the exercise of going through the debate is a
9 lot of fun.

10 For our company, structural separation and other
11 significant regulatory issues are not part of a theoretical
12 monopoly game where the score is tallied up at the end of the
13 day. At Access, it's not promotions and bonuses that are
14 riding on the outcome, it's the survival of our company and the
15 80 jobs we provide in Macon, Georgia.

16 My third message: Access's entry into the structural
17 separation fray is not a regulatory tactic, but a strategic
18 necessity. Our company's survival and success is not the
19 responsibility of this Commission; however, the Commission does
20 have oversight over many issues that influence our company's
21 success. We at Access are gratified that you are looking
22 thoughtfully into this issue. We feel that in the final
23 analysis full structural separation of BellSouth's retail and
24 wholesale channels is the only realistic approach to ensuring
25 its behaviors are supportive of the spirit of the

1 Telecommunications Act of 1996, and the reasons we present are
2 not complex.

3 Number one, currently BellSouth is incapable of
4 developing a meaningful wholesale function that in any way
5 resembles what is customarily found in other industries.
6 Number two, the self-interest of BellSouth's retail channels
7 completely dominate corporate policymaking and operations
8 decisionmaking. Number three, those promises of the
9 Telecommunications Act of 1996 that small ALECs are best
10 equipped to deliver will go unfulfilled until a BellSouth
11 wholesale entity is created that is truly motivated to serve
12 its customers.

13 Until the inevitable structural separation of
14 BellSouth's retail and wholesale units occur, and I am
15 confident it will eventually occur, I cite a historian's
16 observation of George Washington strategy as commander of
17 American forces during the revolutionary war and apply it to
18 our company's survival strategy in the meantime. Quote,
19 "Washington realized that as long as he held the Continental
20 Army together the British would not win the war, which meant
21 they would eventually lose it," closed quote. And to take
22 poetic license and apply that thinking to the current
23 environment, our company and other small ALECs found ourselves
24 in, we realized that as long as we hold ourselves together, we
25 will not lose the war and we will eventually win it.

1 I want to thank you for the opportunity be here
2 today, and I'd be happy to answer any questions. Thank you.

3 MS. LOGUE: Mr. Chairman, Commissioners, the next
4 presenter will be Worldcom. And on behalf of Worldcom is
5 Mr. Gary Ball.

6 MR. BALL: Thank you. My name is Gary Ball. I'm
7 responsible for Worldcom's state policy coordination activities
8 in the eastern U.S. I appreciate the good time slot here at 10
9 after 5:00. I think, as a general matter, I think, it's fair
10 to say that we're in the AT&T-Comptel camp on whether there is
11 a problem and whether some form of structural separations would
12 be a good solution to the problem at hand.

13 I think, I get to be the fourth or fifth person to
14 talk about that. The CLEC industry is not in such great shape.
15 There is a noted lack of competition across the board,
16 especially in the consumer, small business and the DSL areas,
17 and there's especially a lack of facilities-based local
18 competition, which is what, I think, the Telecom Act was
19 contemplating.

20 One of the trends that is somewhat obvious is that as
21 the ILECs enter into these new lines of business, the
22 long-distance business and the retail data business, that
23 there's going to be new forms of discrimination where up to now
24 if Worldcom wanted to lease special Access services from
25 BellSouth or Verizon, BellSouth's not competing with us for

1 that customer's long-distance business. There may be somewhat
2 indifference, if they're the only access providers in town, but
3 there's not that added level of, well, we want to sell
4 long-distance service to this person as well, so maybe our
5 incentives to provide you good access are changed.

6 The third area which we're becoming increasingly
7 concerned with is data and DSL and the level of complexity on
8 these issues and the growing importance of the technology that
9 we're seeing and -- sorry, my computer keeps going out. Stand
10 by. The current regulatory approach under the Telecom Act is
11 basically -- encourages bilateral negotiations. I think, as
12 anybody who has thought through an interconnection negotiation
13 and arbitration process can attest to it's not the most
14 efficient way to get a lot of things accomplished quickly. I
15 think, we still have some appeals pending from contracts that
16 are already expired in a lot of states.

17 On top of that we have the UNE costing issues which,
18 I think, having gone through this UNE costing case in Florida,
19 I think, everyone can attest to that that's also incredibly
20 complex and also controversial. And from our perspective,
21 there isn't a lot of relationship between the retail price for
22 a service and the UNE price, because the retail prices have
23 been set historically to achieve different objectives, and you
24 end up in some areas where the cost of providing service
25 through the UNE platform exceeds the available revenues which

1 makes it a tall order to actually convince any business to
2 actually enter that market.

3 We're also seeing a lot of nonprice issues,
4 especially in states where the ILEC has already achieved
5 long-distance entry where we have seen degradation in their
6 performance on providing things such as special access service.
7 These types of issues are extraordinarily difficult to
8 regulate.

9 It covers the range of agreeing on what parameters
10 actually will be measured, the statistical means of measuring
11 the performance, and the remedies that will be used if the
12 performance isn't met. And some of the problems that arise out
13 of that kind of approach is the availability of information.
14 The ILEC, who is actually doing the work, is going to have more
15 information than both the regulator and its competitors.

16 Secondly, this type of regulation usually only comes
17 about after there's been some kind of problem or some kind of
18 discrimination, so there's also quite a regulatory lag, which a
19 lot of the antitrust regulation, historically, has attempted to
20 work through.

21 We also have the OSS issues which it's not a simple
22 task to demonstrate -- to understand what is parity and try to
23 figure out why, you know, at what level are CLECs getting equal
24 treatment to the incumbent, if the incumbent's not using the
25 same systems as the new entrants.

1 We have recently entered the state of Georgia, and
2 we're attempting to use BellSouth's operational support
3 systems, and there are a tremendous amount of difficulties
4 we've encountered using their systems. There isn't a change
5 control process that we believe allows us to work through a lot
6 of the issues as we're encountering them. And it's really
7 slowed down our entry in Georgia.

8 From our perspective, divestiture for structural
9 separations would create a meaningful split between the retail
10 and wholesale operations. And this would cause actions on the
11 ILEC that we believe are impossible to achieve regulation,
12 mainly because you now have two entities acting in their own
13 self-interest, as opposed to one.

14 I think, going back to the first divestiture, which
15 was actually a little before my time in the industry, but
16 throughout the '70s the type of approach I've encouraged in
17 negotiation with AT&T and trying to work through the disputes
18 was the first choice before AT&T was actually broken up. And
19 it didn't work, because AT&T could never get passed the fact
20 that these people they're negotiating with are going to take
21 their business away once they negotiate with them, so what
22 incentive is that? And I think, as you can see, once the full
23 divestiture in the early '80s actually came about, now you have
24 AT&T suing BellSouth, so I don't think you ever would have got
25 that with a less complete separation.

1 So, from our perspective, the greatest benefit would
2 come from a complete divestiture, recognizing some of the
3 limitations that some states may have in implementing full
4 divestiture, but we feel very strongly that you need to go as
5 far as you can to create what a full divesti-- to create the
6 same time of environment that a full divestiture would provide.
7 And one of the key elements in that is having some separate
8 ownership in the two entities, so the two entities aren't just
9 owned by a common proprietor who is looking to maximize his own
10 profits.

11 Getting the separation in ownership would require a
12 line of business restriction on the monopoly wholesale company,
13 but it would also change their incentives. They would now be
14 forced to treat all the CLECs, including the retail arm, on a
15 more equal footing.

16 We also recognize this would take time to implement
17 and it would be recognized as a long, long solution. And
18 that's why we feel it's important that not only the UNE, UNE-P
19 type issues but also the data and DSL issues get incorporated
20 into the split between the wholesale and the retail arm.

21 Some of the problems to be addressed, like I said,
22 the DSL broadband issues, we think, are really troubling. And
23 the more we get into this, the more troubled we are. If you
24 think about all the regulatory activity over the last two years
25 in the DSL area, it's all being geared towards an assumption

1 that they are facilities-based providers leasing the
2 BellSouth-Verizon loop, putting their own equipment in, and
3 providing their own facilities-based DSL service. Those
4 companies are not -- they're either in bankruptcy or they're
5 going into bankruptcy.

6 We actually have customers, and the products we
7 intend to provide to those customers are based on services we
8 can only get from these facilities-based data CLECs that are
9 going out of business. BellSouth and Verizon does not offer
10 the same type of DSL that we were getting from Rhythms.

11 An example is commitments on the broadband bit rate.
12 We cannot get the type of commitments on bandwidth that we were
13 getting from the data CLECs. We don't have the same voice in
14 the type of DSL providing -- generally, the incumbent LECs are
15 only providing ADSL, which is asymmetric DSL, which is intended
16 for consumers who are following up with their Internet
17 provider.

18 Business customers, especially those wanting to link
19 a lot of their sites to a main corporate data network want a
20 symmetric product that requires different line cards, usually,
21 and also different bandwidth management between the remote
22 terminal and the central office. We can't get that right now
23 from the incumbent LECs. We could get it from the data CLECs,
24 and if the data CLECs do go out of business, there's going to
25 be a need for some increased regulatory oversight on the DSL

1 area.

2 The other issue is UNE pricing. We believe in
3 Florida that the current prices that have been set through the
4 recent UNE case are still too high to promote broad-based entry
5 in Florida, and we believe there's room go down on those
6 prices, and a real meaningful separation between retail and
7 wholesale would mean that the ILECs' retail arm would be in the
8 same price squeeze that we're in and they, hopefully, would
9 have better negotiating leverage with the wholesale provider
10 than we would.

11 The other issue is UNE availability. The FCC has
12 limited the availability of UNEs to certain segments of the
13 market and certain types of technology. We can't use UNE-P for
14 most small and medium businesses or large businesses. We can't
15 get a combination of loops and DSLAMS and packet transport,
16 because the FCC said those aren't under the necessary and
17 impair standard. Without those UNEs being available,
18 competition's going to be limited to wherever the CLECs can
19 survive, and it's not a really robust picture at this point.

20 Some of the other problems, and these -- a lot of
21 these issues we look in the context of post-271 entry. You've
22 got a good one-time carrot with the LD entry, and it does
23 provide some incentive to do some helpful things to
24 competitors, but once the ILEC is in long distance, a lot of
25 the incentive to be helpful goes down.

1 Network and service availability, again, on the DSL
2 arena, there are things we need from the ILECs that we can't
3 get today. And based on the current regulatory environment,
4 it's going to be very difficult to get some of the options on
5 DSL and the bandwidth that we need.

6 Provisioning, we've seen a decrease in special access
7 provisioning in a lot of states post-271 entry. Pricing, we
8 saw this in New York. Verizon got into long distance last
9 year, new UNE case came in this year, and suddenly they
10 proposed all the UNE prices be raised. It appears that the
11 Commission isn't going to allow that, but from an incentive
12 perspective, you can see why wouldn't they?

13 Interfaces, again, on the -- especially on things
14 like UNE P and DSL, it's really critical that the interface
15 that the retail arm of the ILEC is using be, if not identical,
16 comparable to what the competitors are using.

17 On DSL it gets very important because in order to
18 understand whether a customer can either get DSL or not,
19 Verizon has information about how long the customer's loop is,
20 whether it needs to be conditioned. If they're allowed to have
21 that information and their competitors aren't in a real-time
22 basis, they have a tremendous advantage over the competitors.

23 And finally, the customer contact information. If
24 the same people interacting with customers are also involved in
25 the process of shifting those customers over to competitors,

1 there's always -- there are always opportunities for that
2 information to be used to the advantage of the incumbent LEC.

3 So, let me just finish by saying that, first of all,
4 there is a problem. Implementing a meaningful structural
5 separations plan would go a long way, not only to begin fixing
6 some of the short-term problems, but would also provide a
7 structure that would actually allow competition to evolve, both
8 on the local voice and on the data side, so thank you for the
9 opportunity.

10 MS. LOGUE: Mr. Chairman, Commissioners, the final
11 presenter for this afternoon will be Consumers Voice
12 represented by Mr. Robert Johnson.

13 MR. JOHNSON: Mr. Chairman, thank you. We've lost
14 the clip, so I'll hold the microphone. On my watch it's 4:26,
15 so we're four minutes ahead of schedule in Annapolis time.
16 Would you like me to go ahead and start or do you want to wait?

17 COMMISSIONER JACOBS: No, go right ahead.

18 MR. JOHNSON: Oh, okay. Appreciate the opportunity
19 to be here and speak to you today on behalf of Consumers'
20 Voice, a national group that represents telecommunications
21 customers on issues of opening the local telecom market.

22 I dropped my PowerPoint presentation at the last
23 minute, because I knew I was going to be the last presentation
24 of the day, and I knew that much of what I had wanted to say
25 would already be said. I was right in that regard, but what I

1 didn't anticipate and didn't know was that the price for not
2 having a computer screen would be that you all would be looking
3 at a 20-foot wide version of my face, so I ask you to please
4 keep your focus up here and save yourself the bother.

5 At Consumers' Voice, our goal in this whole process,
6 whether it's structural separation or any other aspect of local
7 telephone competition is we want to see all these guys here in
8 the back of the room in the dark suits fighting, not literally
9 but figuratively in the marketplace, but we don't want to see
10 them fighting about whether the rules are set in a way that
11 they can get in -- one side can get into market, and we don't
12 want to see them fighting in a way so that the other side can
13 keep them out of the market.

14 What we want to see is rules that allow everyone fair
15 and equal access to the consumer marketplace, the local
16 telephone network, and then we want to see them fight about
17 what truly matters, which is fight for customers; fight for
18 customers and their business based not upon inherent historical
19 advantages of who owns what facilities, but based upon who can
20 offer consumers best price, the best service, and the most
21 innovative options, that's where the fight should be in the
22 marketplace. The fight should not be in this hearing room or
23 in future times in hearing rooms like this over what are the
24 rules and whether some can get in at the expense of others.

25 Indeed, from our viewpoint, from the perspective of

1 consumers, that should be a given. The marketplace should and
2 must be opened in a way that allows transparent and easy entry
3 on reasonable terms, and then let's let all these guys duke it
4 out with marketing dollars, with customer service dollars, over
5 who can put together the best package to serve consumers.

6 Unfortunately, that is not what we have today. We
7 don't have competition between companies in the local market
8 based on merit. We have competition based upon the ability to
9 control bottleneck facilities and either use those bottleneck
10 facilities to keep others out or those on the outside try to
11 figure out a way to wedge in those bottleneck facilities or
12 around those bottleneck facilities.

13 That is truly, I think, a tragedy and truly a misuse
14 of economic resources, because this is an infrastructure that
15 has been built up over the past 100 years with regulatory
16 dollars granted by this Commission on behalf of a local
17 franchised monopoly.

18 We want BellSouth to continue to have an incentive to
19 gain and maintain and even grow market share, even if it is 94%
20 market share today and even if it's 95% market share tomorrow,
21 but the method by which that company should be gaining market
22 share and retaining market share shouldn't be in terms of its
23 ability to keep out competitors but instead, should be based
24 upon its ability to offer good prices, good service, good
25 innovation to customers.

1 That, unfortunately, is not what we have today. And
2 I believe, based -- and I will not reiterate many of the
3 comments that have been said today, but I think that it's
4 unfortunate that we've come to a point where clearly structural
5 separation is the only way we're ever going to get that
6 possibility of a local market for consumers.

7 Now, my view is admittedly quite simplistic. People
8 who spoke here today are much more knowledgeable on the
9 intricacies of the system than I will ever profess to be, but
10 at the same time I do talk to a lot of consumers and I do talk
11 a lot about this issue to them; and frankly, I think, the issue
12 in front of you, while complicated in its details is, at first
13 blush, very simplistic.

14 When I talk to consumers, I say, "Hey, what do you
15 know about structural separation?" Not many hands go up.
16 There's not a lightbulb of recognition that goes on, but I ask
17 them do you have a choice in who you choose for local telephone
18 service? Maybe one or two occasionally, but usually no, no one
19 has a choice. Indeed, a number of people don't even know that
20 that prospect, that possibility, is out there some day.

21 So, they say, "Well, what is this structural
22 separation thing?" I think, well, how can I explain it? Then,
23 it hit me. Imagine you go to McDonald's or imagine you go to
24 Wendy's or you go to Burger King. And when you go, you think
25 ah, I feel like Wendy's, I want one of those big double bacon

1 cheeseburger things with all the cholesterol sauce on top of
2 it, and you get there and you order your double cheeseburger at
3 Wendy's and the problem is Wendy's can give you a hamburger,
4 but all the ground beef in that town is controlled by
5 McDonald's. So, before Wendy's can actually give you your
6 hamburger, they've got to go knock on the back door of
7 McDonald's and say, "Hey, I need one of those double
8 cheeseburger patties, I've got a live one here on the wire."

9 COMMISSIONER JABER: Mr. Johnson?

10 MR. JOHNSON: Yes.

11 COMMISSIONER JABER: You're not doing me any favors.
12 I haven't eaten yet.

13 MR. JOHNSON: That's swell. Let me ask you, then, do
14 you think that when that Wendy's employee comes back that he's
15 going to get that same quality of hamburger patty, the same
16 timeliness and the same freshness as if you would have gone and
17 bought that hamburger from McDonald's retail operation when all
18 that ground beef is controlled in the backroom? Well, of
19 course, he's not. And if he ever did, Ray Crock would turn
20 over in his grave. That's not way business is done. And that,
21 in a nutshell, is the problem with the local telephone market.

22 There's nothing wrong with what incumbents are doing.
23 In fact, they'd be wrong if they weren't doing it. If you own
24 the marbles, you can make up the rules of the game, and that's
25 what's being done in a very simple sense, and consumers

1 understand that. The problem is that's not the way it's
2 supposed to work. That's not the way the Telecommunications
3 Act of 1996 wanted to it work and that's not the way,
4 ultimately, it should work to benefit consumers.

5 If the only price of this was that we've got a battle
6 slugging out between the rich and the wealthy and a bunch of
7 telephone companies are losing money because they're not able
8 to get into the local market, but that's the only downside, so
9 what, the people that I work with don't really care. But the
10 problem is there's more at stake here. The problem is in the
11 past five years since the Telecom Act was passed, the promises
12 of the benefits of what local choice and local competition
13 could produce also have not materialized, because they also
14 have been the victim of that bottleneck.

15 Indeed, look in the five years since the Telecom Act
16 passed. We've got a declining cost industry in this local
17 telephone market, yet rates remain flat, indeed, and some areas
18 have increased. We have got service quality problems that,
19 like an ugly beast, are rearing their head and all of a sudden
20 it rains in 2000 and 2001, and we've got service quality
21 problems because the local infrastructure hasn't been
22 maintained.

23 And finally, we've got innovation that essentially
24 has ground to a halt. You don't think so? Well, pull out your
25 cell phone. Think of what this thing looked like five years

1 ago. It wasn't too long removed from being one of those big
2 battery-packed boxes you had to carry around on your shoulder,
3 but now not only rolled in do you get all the things you'd come
4 to expect naturally, call waiting, caller ID, three-way
5 calling, but you also get voice mail, you get voice-activated
6 dialing, you get toll-free long-distance calling plans where
7 you can call anywhere nationally at night unlimited minutes,
8 all kinds of things. That's what competition has done in this
9 industry. But on the local side, on the local land line side,
10 we haven't seen similar advances, because there isn't that
11 competitive pressure to produce, to give consumers better
12 prices, better service, better innovation.

13 So, where are we today? Well, unfortunately, today
14 this isn't just an academic exercise. This isn't just a forum
15 that by happenstance happenstance was held in 2001, and if
16 nothing happens we can go back and hold another forum in 2003
17 and see where things were because, I think, we truly are on the
18 brink of a breaking point for the CLEC industry. There are
19 warning signs out there of market failure.

20 One of the things we do at Consumers Voice is we do a
21 lot of work on DSL. For us, DSL is the canary in the mind
22 shaft. It is an indication of whether the local market is
23 working or not and the canary is dying. I can tell you in the
24 last two months, Florida must have been a hot bed of DSL
25 activity, because I've gotten calls from the -- let's see the

1 "Miami Herald," the Fort Lauderdale paper, just the "Palm Beach
2 Post" just last week, all doing stories about DSL providers
3 going out of business out of business and the lurch that
4 customers find themselves in.

5 We know, generally, that nationally CLECs have lost
6 84% of their market cap in the last 14 months. So, this
7 industry really is losing a war of economic attrition and,
8 frankly, I wouldn't care about that but for the fact that when
9 that industry is gone there's going to be no one to compete and
10 bring benefits to consumers.

11 So, you're faced here today with an issue of how to
12 proceed. Essentially, the incumbent local monopolies in this
13 state were created by the state. Then, your goal here, in
14 part, is to figure out how to decrease those monopolies. We
15 thought that passage of TA '96, and that your good work in
16 implementing UNE prices and so on would be enough. I certainly
17 thought that in '96, but it hasn't been. And no amount of
18 empirical evidence, one way or the other, can take away the
19 fact that customers simply don't have a choice in the
20 marketplace.

21 Structural separation promises to finally give them
22 that choice by taking away that bottleneck, not necessarily
23 taking away the bottleneck, but removing it and placing it in a
24 way that aligns the interest; that essentially, as the
25 presentation earlier this afternoon, I think, succinctly put

1 it, it makes everybody a CLEC and makes everybody compete on
2 their own merits. And when that happens, that's when consumers
3 are going to win.

4 So, I very much applaud you for your efforts in
5 opening this docket. The Florida Commission has long been seen
6 nationally, by myself and others, I used to be a SUCCA member
7 for a number of years, as being a leader and you continue to do
8 so in looking at this docket.

9 Structural separation in the end, I think, is the
10 pathway that is going to give you as regulators and the
11 consumers that you collectively represent those 10 million
12 access lines out there three things that really are the key in
13 this market: Structural separation will alleviate that
14 bottleneck control, that market control that exists now and
15 that keeps local competition, not just from emerging, but from
16 really having a chance to emerge.

17 Secondly, structural separation will shift the focus.
18 It will shift the focus from one rich guy in a dark suit trying
19 to battle another rich guy in a dark suit to keep him out of a
20 market or to get into a market, and it will shift the focus to
21 a bunch of guys in dark suits all trying to win consumer
22 business.

23 COMMISSIONER JABER: And girls.

24 MR. JOHNSON: And girls, yes. Guys is a generic
25 term.

1 COMMISSIONER JABER: But that was the third time you
2 used it, so I had to --

3 MR. JOHNSON: Should I use gals? No, that would --

4 COMMISSIONER JABER: No.

5 MR. JOHNSON: No, okay. And finally, when you do
6 this, I think, you'll find that structural separation is,
7 indeed, the missing ingredient. It's not a panacea, but I
8 think it does get you down the road to finally opening that
9 local market and making it work in a way that is
10 self-executing, making it work in a way that aligns interest
11 and that keeps these competitors from coming and knocking on
12 your door and complaining and instead shifts the focus to them
13 duking it out in the marketplace. Be happy to entertain your
14 questions, I very much appreciate your indulgence at this late
15 hour. Thank you.

16 COMMISSIONER PALECKI: I have one question.

17 MR. JOHNSON: Yes.

18 COMMISSIONER PALECKI: If you were to implement a
19 structural separation plan in Florida, what would you do with
20 existing BellSouth customers? And the reason I ask that
21 question is that I've seen in other states and other industries
22 the customers often don't appreciate being forced to make a
23 choice or to change. And how would you answer that as a
24 consumer advocate?

25 MR. JOHNSON: Well, I agree with you that customers

1 want to be left own. And if they want to make a change, they
2 want to make a change on their own time schedule. That's why I
3 very much was attracted to Joe's proposal. I can't remember
4 his last name, but I do know he must have been Joe, proposal to
5 essentially leave those customers alone unless and until
6 there's some affirmative change that either they make or that
7 causes them to have to selectively go out and choose another
8 provider.

9 That made a lot of sense, because you don't get a
10 huge upheaval in terms of customers being foisted from one
11 company and assigned to another. It also made a lot of sense
12 in that it incrementally allowed the market to grow so that you
13 could work through growing pains that inevitably come, because
14 you can't go from zero to 100% market share in one day.

15 So, I thought, whether that approach is the answer or
16 not, I don't know. It's the first time I've seen that model,
17 but something that respects the rights of individual consumers
18 to stay where they are and to be left alone, I think, deserves
19 serious attention.

20 COMMISSIONER PALECKI: Thank you.

21 MR. JOHNSON: Thank you, Mr. Chairman.

22 COMMISSIONER JACOBS: Thank you very much. It was
23 worth the wait. Anything else, Staff?

24 MS. LOGUE: Mr. Chairman, Commissioners, that
25 concludes today's presentations. As far as housekeeping

1 matters are concerned, tomorrow morning we do start promptly at
2 8:30 a.m. Presenters were told today that they know to have
3 their computers and presentations ready to go before we get in
4 here. We will also, again, have audio access tomorrow.

5 And tomorrow's presenters will be IDS, the American
6 ISP Association, the Progress and Freedom Foundation, Verizon,
7 and BellSouth. And closing remarks will be made from 3:30 to
8 5:00 p.m. with the ALEC side going first from 3:30 to 4:00, the
9 ILEC side from 4:00 to 4:30, and then any Commissioner closing
10 remarks from 4:30 to 5:00.

11 COMMISSIONER JACOBS: Thank you very much. And with
12 that, we are in recess for the evening to re-adjourn at 8:30 in
13 the morning.

14 (Transcript continues in sequence in Volume 2.)

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1 STATE OF FLORIDA)
2 : CERTIFICATE OF REPORTER
3 COUNTY OF LEON)

4

5 I, KORETTA E. STANFORD, RPR, Official Commission
6 Reporter, do hereby certify that a Workshop was heard at the
time and place herein stated in Docket Number 010345-TP.

7 IT IS FURTHER CERTIFIED that I stenographically
8 reported the said proceedings; that the same has been
transcribed under my direct supervision; and that this
9 transcript constitutes a true transcription of my notes of said
proceedings.

10 I FURTHER CERTIFY that I am not a relative, employee,
11 attorney or counsel of any of the parties, nor am I a relative
or employee of any of the parties' attorneys or counsel
12 connected with the action, nor am I financially interested in
the action.

13 DATED this Monday, August 13, 2001.

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KORETTA E. STANFORD, RPR
FPSC Official Commissioner Reporter
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