

ORIGINAL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

990649A

FINAL REVISED SUPPLEMENTAL REBUTTAL TESTIMONY OF

JOSEPH P. GILLAN

ON BEHALF OF

AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.

And

MCI WORLDCOM, INC.

Docket No. 990649A-TP

Filed February 15, 2002

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1 **Q. Please state your name, business address and occupation.**

2

3 A. My name is Joseph Gillan. My business address is P. O. Box 541038,
4 Orlando, Florida 32854. I am an economist with a consulting practice
5 specializing in telecommunications.

6

7 **Q. On whose behalf are you testifying?**

8

9 A. I am testifying on behalf of WorldCom, Inc. and AT&T Communications
10 of the Southern States, Inc. (the "ALECs").

11

12 **Q. Why is your testimony labeled as "final revised" testimony?**

13

14 A. Over the course of this proceeding, there have been a number of updates to
15 BellSouth's cost testimony, as well as the testimony of the ALECs.
16 Needed information was not always available to meet various procedural
17 deadlines, but in an effort to be as responsive as possible, versions of my
18 testimony were filed providing as much detail as was then available. This
19 process should now be concluded. To eliminate any potential for
20 confusion, I am refiling my testimony and exhibits as "final revised,"
21 incorporating all previous revisions and corrections, as well as
22 incorporating the final proposed ALEC rates. (I am also refiling all my
23 exhibits as "final revised" to assure consistent labeling).

1

2 **Q. What is the purpose of your testimony?**

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4 A. The purpose of my testimony is to place the opposing recommendations of
5 the ALECs and BellSouth into a context that makes comparisons simpler
6 (and more relevant). Cost proceedings are unavoidably complex and
7 detailed, and it is easy to lose sight of the larger context. The purpose of
8 my testimony is to step back and describe the “forest,” while other ALEC
9 witnesses address each of the specific “trees.” Consequently, rather than
10 focus on individual cost inputs or components, the testimony evaluates a
11 more relevant “roll-up” – the total cost of a basic UNE-Platform (UNE-P)
12 used to serve the average Florida customer.

13

14 **Q. How important are UNE-rate levels to local competition?**

15

16 A. UNE rate levels are critically important to local competition, particularly
17 competition for the vast majority of residential and business customers
18 with conventional, analog telecommunications needs. As a practical
19 matter, given existing technologies and capital markets, these customers
20 are only likely to see competition by forms of entry that rely extensively
21 on access to UNEs (more specifically, the UNE-P).

22

1 It is important to bear in mind that BellSouth's Florida exchange network
2 is fundamentally an inherited resource – this network is the cumulative
3 product of more than 100 years of protected investment, encouraged (in
4 part) by its explicit subsidization for most of the latter half of the past
5 century. As a result, this remarkable public-private network enjoys
6 substantial economies of scale and scope, and may still be a natural
7 monopoly in many respects. One of the core reasons that the
8 Telecommunications Act requires that incumbents (like BellSouth) offer
9 UNEs is so that these inherited scale and scope economies can be *shared*
10 by all providers, rather than shielding BellSouth from competition and
11 entry.

12
13 Without access to UNEs, BellSouth's exclusive access to this network
14 would provide it an (probably) insurmountable advantage, thereby
15 solidifying its dominance, particularly in the core market of residential and
16 smaller business customers with basic telecommunications needs. It is no
17 understatement to say that the future of local competition is directly
18 related to UNE rates, for it is these rates that will determine whether other
19 entrants are provided access to this critical network resource equal to that
20 which BellSouth provides itself.

21

22 **Q. Is there a substantial difference between the rate proposals of the**
23 **ALECs and BellSouth?**

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A. Yes. BellSouth's rates produce a statewide average cost (to serve the average POTS user) of approximately \$25.13 per line, per month. In contrast, the ALECs' proposed rates produce an average UNE cost of \$13.76. The principal difference between the proposals (at least with respect to those UNEs necessary to offer basic POTS arrangements) are that the ALECs recommend the elimination of BellSouth's charges for "daily usage information," and lower rates for the analog loop.

Q. Have you done an analysis to judge the plausibility of BellSouth's proposed UNE rates?

A. Yes. To get a sense of whether BellSouth's claimed UNE costs are reasonable, I "bracketed" their proposal with two comparisons. First, I compared BellSouth's claimed UNE-cost of its local network to the network-related costs that it actually reported for 2000. Second, I compared these same UNE-costs to BellSouth's 2000 revenues to determine whether even BellSouth could profitably operate if it were required to obtain access to the network like any other ALEC.

Q. How do BellSouth's claimed UNE-costs compare to its reported costs for 2000?

1 A. As shown on Exhibit JPG-1 (illustrated in JPG-3), BellSouth's claimed
2 UNE-costs exceed its reported network-related expenses (Plant Specific
3 Operating Expense, Plant Non-Specific Operating Expense, Corporate
4 Operating Expense, Depreciation and Amortization Expense) by nearly
5 \$290 million in 2000. Moreover, the analysis is conservative – that is,
6 BellSouth's claimed UNE-costs are higher than its reported costs by an
7 even larger amount – because of two assumptions in the analysis.

8
9 First, the analysis assumes that 100% of BellSouth's Corporate Operations
10 Expense is network-related. Obviously, not all (or, perhaps, even most) of
11 BellSouth's Corporate Operations expenses are incurred in support of
12 network operations. Consequently, by attributing all of these expenses to
13 network operation, the analysis overstates the costs that BellSouth actually
14 incurred in 2000.

15
16 Second, the analysis estimates the total UNE-cost for switched services
17 only, while BellSouth's incurred expense in support of both switched and
18 non-switched services in 2000. The portion of BellSouth's 2000 reported
19 network expense is likely to be substantial – non-switched services
20 account for nearly 35% of BellSouth's lines in Florida (ARMIS 43-08),
21 and are typically more difficult (and, therefore, more expensive) to
22 provision. The analysis in JPG-1 includes the cost of non-switched
23 services in BellSouth's reported expenses (but not its UNE-cost estimate),

1 thereby understating the extent to which BellSouth's claimed UNE-cost
2 levels exceed its actual reported costs.

3

4 **Q. How do BellSouth's claimed UNE costs compare to its annual**
5 **revenues?**

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7 A. Also shown in Exhibit JPG-1 is an estimate of BellSouth's Florida
8 operating income, assuming that BellSouth's actual levels of customer,
9 marketing and corporate operations expense were unchanged, and its
10 network cost replaced by the cost to lease the needed number of UNE-Ps.
11 Because BellSouth would be leasing UNEs rather than owning its
12 network, the analysis does not include any expense for depreciation or
13 plant-related operating costs. Moreover, the analysis provides a
14 conservative estimate of the expenses that BellSouth would *actually* incur
15 if it attempted to compete leasing network elements from itself because
16 the analysis does not include the non-recurring cost to serve new lines or
17 migrate customers.

18

19 As shown in Exhibit JPG-1, BellSouth's "UNE-self" would have barely
20 covered its costs, producing a gross margin of only 14% (contrasted with
21 the 44% gross margin that BellSouth actually enjoyed in Florida in 2000).
22 Of course, a "real" entrant would have to offer reduced rates to win
23 customers from BellSouth, and would thus not even realize the razor-thin

1 margin estimated here. (I note that the ALECs' proposed rates would
2 produce for BellSouth's "UNE-self" a gross margin of 43%, still lower
3 than – but certainly closer to – the actual return that BellSouth enjoyed).

4
5 **Q. Are BellSouth's UNE rates affecting local competition in Florida?**

6
7 A. Yes. Although Florida is the largest state in the BellSouth region -- and
8 should, therefore, be its most attractive market -- Florida trails other states
9 in competitive development. It is important to appreciate that Florida
10 must compete with these other states (as well as other states in the nation)
11 for competitive resources and attention. The more unattractive the
12 economics in Florida, the less likely carriers will introduce new services,
13 products and prices here.

14
15 Exhibit JPG-2 compares the state of UNE-based competition with other
16 states in the BellSouth region and nationally. At the end of last year, UNE
17 penetration in Florida was 2.1%, while in Georgia UNE penetration was
18 nearly 80% larger (3.7%). More recent data indicates that UNE
19 penetration in GA is continuing to increase, fueled largely by the growth
20 of UNE-P. Exhibit JPG-2 also contrasts competition in Florida to two
21 other urban States for which I have comparable data: Illinois and Texas.
22 As those comparisons show, Florida is trailing national leaders in the

1 development of local competition, and trailing other States in the
2 BellSouth region as well.

3

4 There is no question that the State of Florida has chosen competition as
5 the principal defense against BellSouth's market power. This goal,
6 however, can only become a reality if UNE-rates provide entrants a
7 meaningful opportunity to compete by accurately reflecting the underlying
8 cost of this local network. Nothing in my testimony is intended to suggest
9 that the Commission should establish UNE-rates without regard to
10 underlying costs – but where the Commission applies its judgment, it is
11 useful to consider its implication.

12

13 **Q. Does this conclude your testimony?**

14

15 **A. Yes.**

Claimed UNE Costs and Reported Expenses

Annual UNE Cost	
BellSouth Claimed UNE Cost per Line ¹	\$25.13
Number of Lines	6,850,656
BellSouth's Claimed Annual UNE Cost	\$2,065,884
BellSouth Network Expenses (ARMIS 2000)²	
Plant Specific ³	\$427,076
Plant Non-Specific	\$183,378
Depreciation and Amortization	\$881,894
Corporate Operations ⁴	\$284,244
BellSouth Reported Network Expense	\$1,776,592

BellSouth as UNE-Based ALEC – Switched Services

Revenues ⁵	\$3,239,076
Costs	
UNE Lease Cost	\$2,065,884
Marketing	\$145,716
Customer Services	\$275,164
Exec & Planning	\$36,993
General & Admin	\$247,243
Total Operating Expense	\$2,771,000
Comparing Net Income	
BellSouth UNE-Self (above)	\$468,077
BellSouth Realized in 2000 ⁶	\$1,825,416

¹ Based on average calling patterns reported by BellSouth in ARMIS 43-08, Table IV.

² Source: ARMIS 43-01, Table 1 (Regulated Expenses).

³ Plant Specific Expenses excludes costs associated with pay telephones, PBX and station apparatus (Account 6310).

⁴ Analysis assumes that 100% of Corporate Operations Expense is network-related. This assumption significantly overstates BellSouth's actual network-related costs by the amount of Corporate Operations Expenses that are unrelated to network operations.

⁵ Revenues include Basic Local Revenues, Extended Area Revenues, End User Revenues, Switched Access Revenues, IntraLATA Toll Revenues, State Access Revenues (ARMIS 43-03), as well as an estimate of BellSouth's Optional Feature Revenues derived from its 3rd Quarter 2000 earnings report.

⁶ Source: ARMIS 43-03 (Regulated Operating Revenues less Regulated Operating Expense), Florida 2000.

**Relative UNE Penetration
 As of December 2000¹**

BellSouth Region			
	UNE-L	UNE-P	Total
Georgia	1.9%	1.8%	3.7%
Tennessee	1.7%	0.6%	2.3%
North Carolina	1.4%	0.9%	2.3%
Florida	1.3%	0.7%	2.1%
Alabama	0.8%	1.0%	1.8%
South Carolina	0.8%	0.5%	1.2%
Kentucky	0.4%	0.8%	1.2%
Mississippi	0.4%	0.4%	0.8%
Louisiana	0.5%	0.4%	0.8%
Other Major States			
Illinois	3.9%	1.9%	5.8%
Texas	1.6%	13.5%	15.1%

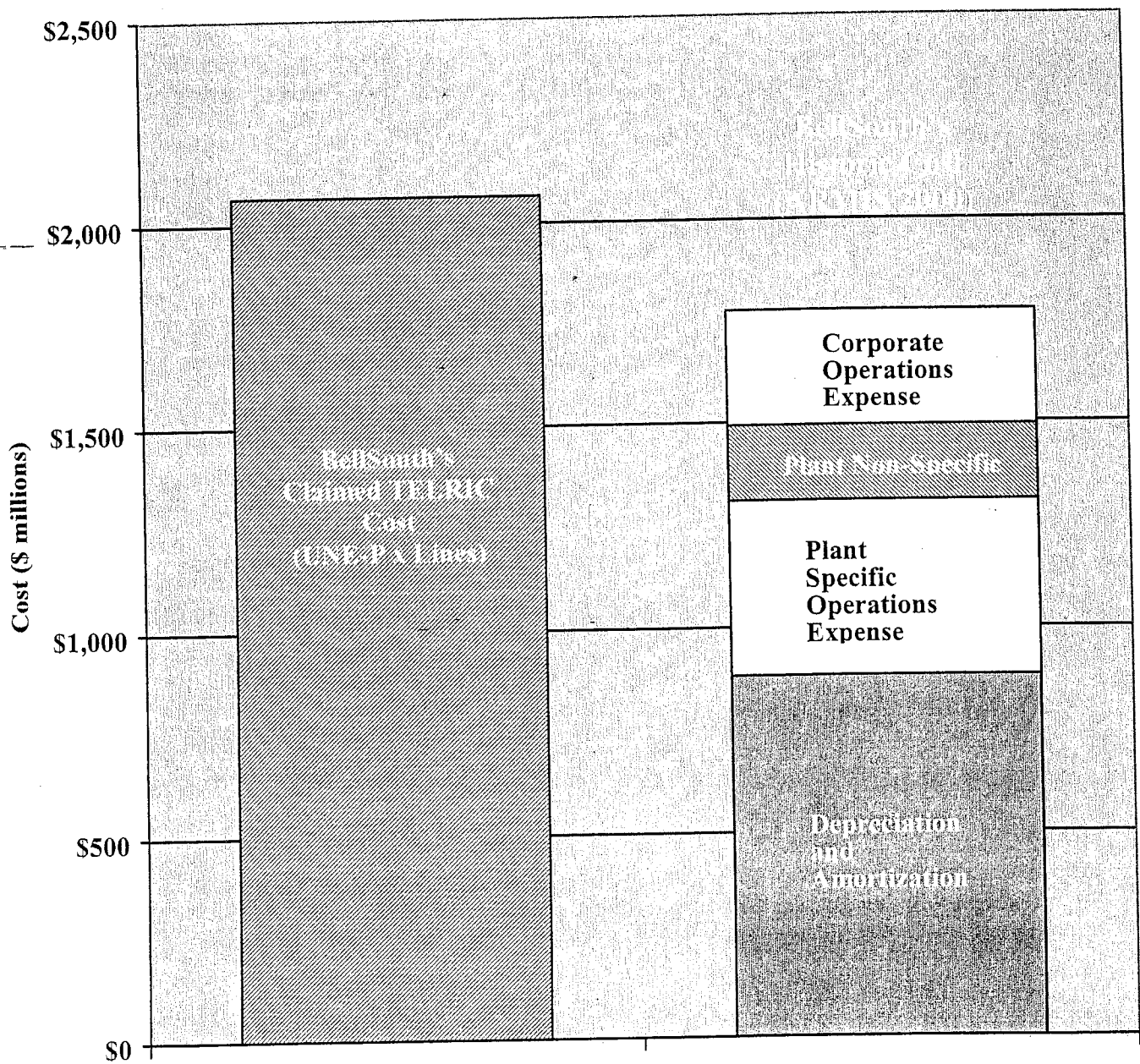
UNE Growth: Georgia

	UNE-L	UNE-P	Total	Share
As of December 2000	80,698	78,068	158,766	3.7%
As of July 2001 ²	84,219	144,420	228,639	5.4%
	4.4%	85.0%	44.0%	

¹ Source: FCC Form 477.

² Source: Letter from Sean Lev to Magalie Roman Salas, Secretary, Federal Communications Commission, CC Docket 01-277, October 10, 2001.

Comparing BellSouth's Claimed TELRIC Cost to Embedded Network Expenses for 2000



Components of the Average UNE-P Cost

BellSouth Proposed Rates				
	Zone 1	Zone 2	Zone 3	Average
Fixed (Loop/Port)	\$14.92	\$19.40	\$50.16	\$19.26
Features	\$2.26	\$2.26	\$2.26	\$2.26
Usage (Switching and Transport)	\$2.67	\$2.67	\$2.67	\$2.67
Billing Info (DUF Files)	\$0.94	\$0.94	\$0.94	\$0.94
Total Cost	\$20.79	\$25.22	\$56.03	\$25.13
ALEC Proposed Rates				
	Zone 1	Zone 2	Zone 3	Average
Fixed (Loop/Port)	\$6.53	\$9.19	\$19.70	\$8.83
Features	\$2.26	\$2.26	\$2.26	\$2.26
Usage (Switching and Transport)	\$2.67	\$2.67	\$2.67	\$2.67
Billing Information (DUF Files)	\$0.00	\$0.00	\$0.00	\$0.00
Total Cost	\$11.46	\$14.12	\$24.63	\$13.76