

Florida
Digital
Network

ORIGINAL

November 25, 2002

Ms. Blanca Bayó, Director
Division of the Commission Clerk
& Administrative Services
Florida Public Service Commission
2540 Shumard Oak Blvd.
Tallahassee, FL 32399-0850

via Hand Delivery

COMMISSION
CLERK

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REGISTRATION PSC

Re: Docket No. 020119 – Petition for Expedited Review and Cancellation Of BellSouth Telecommunications, Inc.’s Key Customer Promotional Tariffs and For an Investigation Of BellSouth’s Promotional Pricing And Marketing Practices by Florida Digital Network, Inc.

Re: Docket No. 020578 -- Petition for Expedited Review and Cancellation Of BellSouth Telecommunications, Inc.’s Key Customer Promotional Tariffs by the Florida Competitive Carrier’s Association

Dear Ms. Bayó,

Please find enclosed for filing in the above dockets on behalf of Florida Digital Network (“FDN”), an original and twenty-one (21) copies of the prefiled rebuttal testimony and exhibit of Michael P. Gallagher and an original and ~~seven (7)~~¹⁵ copies of FDN’s Prehearing Statement. A diskette containing an electronic copy of the above is also enclosed.

If you have any questions regarding this request, please call me at 407-835-0460. Thank you.

Sincerely,



Matthew Feil
Florida Digital Network
General Counsel

COMM
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SEC
OTH

12/25/02

12/25/02

Prehearing
Statement
DOCUMENT NUMBER DATE

12930 NOV 25 02

REGISTRATION CLERK

M. P. Gallagher's
Rebuttal Testimony
DOCUMENT NUMBER-DATE

12929 NOV 25 02

REGISTRATION CLERK

LOCAL LONG DISTANCE INTERN

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Petition for Expedited Review }
and Cancellation of BellSouth }
Telecommunications, Inc.'s Key Customer } Docket No. 020119-TP
Promotional Tariffs and For an }
Investigation Of BellSouth's Promotional }
Pricing And Marketing Practices by }
Florida Digital Network, Inc. }
_____ }

In Re: Petition for Expedited Review }
and Cancellation of BellSouth }
Telecommunications, Inc.'s Key Customer } Docket No. 020578-TP
Promotional Tariffs by the Florida }
Competitive Carrier's Association }
_____ }

REBUTTAL TESTIMONY OF
MICHAEL P. GALLAGHER

FILED ON BEHALF OF
FLORIDA DIGITAL NETWORK, INC.

DOCUMENT NUMBER - DATE

12929 NOV 25 88

FPSC-COMMISSION CLERK

1 **Q. Please state your name and address.**

2 A. My name is Michael P. Gallagher. My business address is Florida Digital
3 Network, 390 North Orange Avenue, Suite 2000, Orlando, Florida, 32801.

4 **Q. Are you the same Michael Gallagher that provided direct testimony**
5 **in this case?**

6 A. Yes.

7 **Q. What is the purpose of your rebuttal testimony?**

8 My rebuttal testimony will cover several, mostly thematic, points regarding
9 competition and competitors, discrimination, termination liability and resale.
10 I preface my rebuttal testimony, however, with this general comment. I think
11 that much of the controversy surrounding this case could have been avoided
12 had BellSouth simply offered across-the-board rate decreases to all of its
13 customers rather than geographically targeting such unreasonably steep
14 decreases (up to 40% off with hunting) to just a group of customers in
15 specific geographies where Florida's developing competitors operate. With
16 across-the-board decreases, all of BellSouth's customers could share in the
17 benefits of competition and claims of discrimination and unfairness could be
18 diminished. As I will mention later in this testimony, FDN supports the
19 Commission's requiring any rate decreases BellSouth offers be across-the-
20 board decreases so all BellSouth customers may share in the benefits of
21 competition.

22 **Q. BellSouth's witnesses point out that ALEC market share has grown**
23 **during the period BellSouth promotions were in effect and argue that**

1 **there should be no limitations on the duration of BellSouth's promotions**
2 **or the customer contracts with promotional discounts because such**
3 **limitations could actually limit customer choice. How do you respond?**

4 I think these witnesses turn a blind eye to several important considerations.
5 Chief among these is that the Commission must look at the full effects of
6 BellSouth promotions on competition and on competitors today and
7 anticipate the impacts over a 3 – 5 year horizon.

8 Even if one accepts that competitors have made gains in overall
9 market share in years past, the ALECs' market share is fragmented, i.e., it
10 takes a hundred ALECs' market shares all added together to arrive at a total
11 that does not even come close to BellSouth's market share. No one can
12 seriously dispute that BellSouth has dominant market power in its incumbent
13 Florida territory today, and BellSouth's status will certainly continue for as
14 long as the Commission permits BellSouth's anticompetitive promotion
15 tactics.

16 BellSouth's market power is significant to this case because
17 BellSouth has the ability to influence and alter the entire competitive
18 landscape by its conduct. BellSouth's competitors do not have that ability.
19 BellSouth is in a position to threaten the very existence of ALECs; the
20 reverse is certainly not true. This is why BellSouth's promotions must
21 receive a high level of scrutiny and why BellSouth's practices generally
22 cannot be judged by the same standards as ALEC practices.

1 The Commission cannot look at a BellSouth estimate of current
2 ALEC market share and say that the analysis in this case ends at that. The
3 Commission must evaluate whether the rate of ALEC market share gains has
4 slowed and whether and how the rate will slow in the future. FDN maintains
5 that over time, the rate of ALEC market share gains are likely to stagnate as
6 long as BellSouth's Key Customer type promotional rates are in effect. The
7 Commission has to ask if this is a desirable result for Florida -- slow or no
8 growth for competitors -- because that result has consequences. If the rate of
9 ALEC market share growth stagnates, ALECs will falter, and there will be
10 fewer or no real competitive choices for Florida consumers. When the
11 competitive threat is diminished, BellSouth will be free to raise prices to all
12 customers just as it has already done for many of its customers in Florida.

13 To have competition that benefits Florida consumers, the Commission
14 has to have healthy competitors with meaningful prospects for sustainable
15 growth. As alluded to in my direct testimony, the Commission should also
16 bear in mind that the BellSouth promotions do not affect resellers (who may
17 wish to resell the promotions) in the way that they affect facilities-based
18 carriers. A reseller's margins may not change measurably if it resells
19 BellSouth promotions (the wholesale discount is the same regardless).
20 However, a facilities-based carrier's margins can change dramatically and
21 take a devastating turn if it tries to beat BellSouth's promotional prices or
22 move to resale. Therefore, if the Commission is indeed serious in its
23 commitment to promote true facilities-based competition, the long-term

1 viability of those facilities-based carriers has to be preserved or Florida's
2 consumers will not have the benefits of choice down the road.

3 BellSouth witnesses Ruscilli and Taylor ignore other important
4 factors in relation to BellSouth's market status and promotional rate duration.
5 Not only is competition in the local exchange market new, but the
6 competitors are new. Many ALECs are not decades-old enterprises that have
7 reached the point where their businesses "scale." Rather, the ALEC market
8 entrants are new businesses with significant capital and customer acquisition
9 costs and few customers over which to spread those costs. These companies
10 cannot and do not compete on the same or equal footing with the century-old
11 monopoly that is BellSouth. And these companies operate in distinct
12 geographic areas for cost reasons, many attributable to their newness.

13 The success or failure of the embryonic ALEC enterprises depends
14 substantially on customer growth and customer churn – two variables directly
15 and negatively impacted by BellSouth's promotions. For if the customer
16 base for ALECs fails to grow at a significant rate over a short period, the
17 ALECs will not reach scale and will not have enough customers over which
18 to spread costs, thus increasing the likelihood of financial distress. Recall
19 from my direct testimony the differences between an ALEC and BellSouth
20 each losing a 100 line customer. The ALEC loses revenue, suffers significant
21 unrecovered costs, and endures a substantial impact on the bottom line;
22 whereas BellSouth does not suffer the same proportional impact to its bottom
23 line as does the ALEC, and any retail revenue retail BellSouth suffers is

1 cushioned by the wholesale revenue BellSouth will almost assuredly get from
2 a competitor acquiring the customer. Meanwhile, BellSouth's competitors
3 weaken over time from stagnating growth, which benefits BellSouth over the
4 long haul, and BellSouth can collect higher rates from customers when they
5 are not susceptible to leaving for other providers. BellSouth has all its bases
6 covered! And BellSouth's answer to the ALECs only 3 years or so in
7 business is to try, at the ALECs' financial peril, to beat the promotional
8 prices or resell the promotions -- neither of which are viable options as I
9 explained in my direct testimony.

10 Promoting competition as the '96 Telecommunications Act and the
11 Florida Statutes intended cannot mean just focusing in on the short-term
12 interests of just a few customers fortunate enough to get lower rates today.
13 Promoting competition should be about protecting the best interests of all
14 telecommunications customers over the long term. The Commission cannot
15 protect the long-term public interest if it permits one firm with market power
16 to cripple that firm's lesser competitors (who are just starting out in the
17 business) through unreasonable discounts targeted only at those geographies
18 where the lesser competitors operate. The damage is not just that ALEC A or
19 ALEC B loses a customer today. It is the cumulative effect of those losses
20 and the future harm resulting from the dominant firm's locking up customers
21 for the long term, during the infancy of the competitors, and deterring those
22 customers from migrating in the future. Further, there is the damage done to

1 the dominant firm's customers who do not share in the benefits of
2 competition because they do not receive rate decreases, as they should.

3 If the Commission is not going to outright stop BellSouth from
4 offering promotional prices in limited geographic areas, the Commission
5 surely must recognize the potential for these BellSouth promotions to stifle
6 competition over time and the need for the Commission to reserve the power
7 or have mechanisms in place to "put on the brakes" and stop negative
8 competitive impacts before it is too late to reverse those impacts. This is
9 precisely why the Commission must place a meaningful limit on the duration
10 of any tariffed promotions and on any agreement or eligibility terms, as well
11 as addressing termination liability. If the Commission realizes at an annual
12 review that total ALEC growth is limping along at 5%, it may be too late to
13 stop the cumulative effect of prior promotions, or even stop BellSouth's 8th
14 Key Customer tariff, so as to do anything to alter the course that the dominant
15 BellSouth has set for the market. Too many customers will already be locked
16 up with BellSouth, and Commission action to release those customers already
17 signed up with BellSouth from termination liability provisions may prove too
18 difficult.

19 I disagree with the arguments of BellSouth's witnesses that duration
20 limits are unnecessary, and FDN recommends a tariff duration limit and a
21 limit on contract duration of one year with at least a one year "off promotion"
22 period (before a customer who received a discount can again qualify for
23 another). Aside from serving as a means for the Commission to cushion any

1 problems that develop in the competitive marketplace as a result of the
2 promotions, this would also restore some measure of equity to the situation of
3 so many customers not receiving promotional prices because BellSouth has
4 not offered across-the-board decreases.

5 **Q. Do you agree with Mr. Ruscilli's and Dr. Taylor's assessment of the**
6 **discrimination issues in this case?**

7 No. FDN maintains that BellSouth is unduly discriminating among its
8 customers without justification, as explained in my earlier testimony. This
9 notwithstanding, for BellSouth to justify treating customers in the same class
10 disparately for reasons other than cost differences (such as the Key Customer
11 promotions do), the Commission should require BellSouth to show that the
12 customers not receiving the promotions benefit from the discrimination. I do
13 not believe that BellSouth has yet made such a showing, because instead of
14 getting rate decreases, BellSouth customers not eligible for BellSouth's
15 promotions have felt the full brunt of rate increases. Those customers have
16 not benefited from BellSouth's promotions or from competition.

17 Attached hereto as Exhibit __ (MPG-5) is a schedule showing the rate
18 increases BellSouth has implemented for single and multi-line business
19 customers since January 2000. Over this period, BellSouth's line rates for
20 some multi-line business customers have gone up over 30%. And these are
21 business customers who have traditionally paid more than the true cost of
22 service so as to contribute to lower residential rates. Thus, it appears

1 customers not receiving BellSouth's promotions are not benefiting from the
2 promotions.

3 I note that on page 11, line 16, of his direct testimony, BellSouth
4 witness Garcia, states "Competition is everywhere in Florida, but is most
5 fierce in the 'hot wire centers'" (Emphasis added.) Only some
6 BellSouth customers, however, get the full benefits of this "everywhere"
7 competition.

8 The discrimination issues in this case present several choices for the
9 Commission, but I would like to highlight one of the main dilemmas. To
10 approve BellSouth's arguments, the Commission must ignore equity and tell
11 BellSouth customers not receiving promotional rates that not only do they not
12 qualify for lower rates through no fault of their own, but they will have to pay
13 higher rates. Inevitably, those customers will believe that they are financing
14 the customers receiving the lower promotional rates.

15 To eliminate this unfair discrimination, FDN supports across-the-
16 board rate decreases for all BellSouth customers. In so doing, the
17 Commission will counter the ALEC arguments that BellSouth
18 inappropriately targets specific geographic markets and that BellSouth
19 unfairly utilizes its market position. Further, with an across-the-board
20 decrease, all BellSouth's customers benefit from competition, and, just as
21 importantly, none are harmed by it through no fault of their own. The
22 Commission will then not have the difficult task of explaining to customers
23 not receiving promotions that their rates have somehow gone up instead of

1 down as a result of competition. The Commission should protect the interests
2 of all of BellSouth's customers, not just a few of them, as competition
3 develops and require any BellSouth rate reductions to apply across-the-board.

4 **Q. How do you respond to Mr. Ruscilli's and Mr. Casey's contentions**
5 **regarding termination liability of the Key Customer offerings?**

6 In its pleadings in this case, FDN did not initially object to the termination
7 liability provisions in BellSouth's promotions on the grounds that they were
8 an inappropriate measure of liquidated damages. FDN objected to the
9 termination liability provisions on the basis that they were anticompetitive. It
10 is no answer at all for BellSouth to say that its termination liability provisions
11 are like those of many ALECs and therefore not anticompetitive. This is not
12 an issue of creating disparate rules for ILECs versus ALECs. This is an issue
13 of a firm with dominant market power locking up customers in specific
14 geographic areas over an extended duration and what impact that has on
15 competition. It is simply not reasonable to suggest that the impact in the
16 competitive market place of an ALEC and BellSouth having similar
17 termination liability provisions is the same when the ALEC has .015%
18 market share and BellSouth has 90% plus market share. Moreover, look at
19 the practical results of BellSouth v. ALEC termination liability. BellSouth
20 asserts that droves and droves of Florida ALECs have termination liability
21 provisions just like BellSouth. And yet, customers leave ALECs for
22 BellSouth, while, on the other hand, as borne out by BellSouth's discovery
23 responses, very few customers leave BellSouth's promotions. FDN's

1 position regarding termination liability from my direct testimony should be
2 adopted. It is anticompetitive for BellSouth as the dominant firm to lock up
3 customers in the manner the Key Customer tariffs permit.

4 **Q. How do you respond to Dr. Taylor's testimony regarding the role of**
5 **resale in a price squeeze analysis?**

6 A. To the extent Dr. Taylor suggests on pages 8 – 9 of his testimony (and
7 thereafter) that that the availability of resale cancels out the requirement for a
8 price squeeze analysis, I disagree. Basically, Dr. Taylor argues that since
9 resale of promotions is available, a UNE loop is no longer a monopoly or
10 essential facility to the competitor because the competitor can use other
11 means (i.e. resale) to provide service, and therefore a price squeeze analysis
12 is inapplicable. I do not agree that a loop, which is a UNE by definition and
13 for which a UNE rate is set (because the FCC correctly considers it a facility
14 that competitors need), disappears from UNE status for purposes of a price
15 squeeze analysis only, and is somehow no longer needed because resale is
16 available. It appears Dr. Taylor argues that there should never be a price
17 squeeze under the law where a resale opportunity is available. As I
18 mentioned in my direct testimony, this sort of argument turns the promotion
19 of facilities based competition completely on its head. BellSouth seems
20 content with on the one hand arguing that true facilities based competition is
21 desirable (while RBOCs try to lobby the complete elimination of UNE-P as
22 being little more than resale) and then, on the other hand, arguing that a price
23 squeeze, no matter how egregious, no matter what negative impact it may

1 have on the newly-formed facilities based carriers in the market, may be
2 excused so long as resale is available. BellSouth's price squeeze and resale
3 arguments must be rejected. BellSouth's resale option does not excuse its
4 anticompetitive and discriminatory pricing.

5 **Q. Does that conclude your rebuttal testimony?**

6 A. Yes.

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BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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EXHIBIT MPG-5

FILED WITH THE REBUTTAL TESTIMONY OF
MICHAEL P. GALLAGHER

FILED ON BEHALF OF
FLORIDA DIGITAL NETWORK, INC.

BellSouth Rate Increases

	all lines	multi-line additive	multi-line increase	multi-line	multi-line increase	multi-line	multi-line increase	multi-line	multi-line increase	multi-line	multi-line increase	Total multi-line increase
RG	1/15/2000	1/15/2000	1/15/2000	1/19/2001	1/19/2001	2/2/2001	2/2/2001	1/19/2002	1/19/2002	2/16/2002	2/16/2002	1/15/00 - 2/16/02
1	19.80	21.40	8.081%	23.05	7.710%	23.36	1.345%	25.95	11.087%	25.95	N/A	31.06%
2	20.80	22.48	8.077%	24.22	7.740%	24.54	1.321%	26.95	9.821%	26.95	N/A	29.57%
3	21.90	23.67	8.082%	25.50	7.731%	25.84	1.333%	28.95	12.036%	28.95	N/A	32.19%
4	22.90	24.75	8.079%	26.66	7.717%	27.01	1.313%	29.95	10.885%	29.95	N/A	30.79%
5	23.85	25.78	8.092%	27.77	7.719%	28.14	1.332%	30.95	9.986%	30.95	N/A	29.77%
6	24.90	26.92	8.112%	28.99	7.689%	29.38	1.345%	32.95	12.151%	32.95	N/A	32.33%
7	25.75	27.84	8.117%	29.98	7.687%	30.38	1.334%	33.95	11.751%	33.95	N/A	31.84%
8	26.60	28.75	8.083%	30.97	7.722%	31.38	1.324%	34.95	11.377%	34.95	N/A	31.39%
9	27.40	29.62	8.102%	31.90	7.698%	32.32	1.317%	36.95	14.325%	36.95	N/A	34.85%
10	28.00	30.27	8.107%	32.60	7.697%	33.03	1.319%	36.95	11.868%	36.95	N/A	31.96%
11	28.60	30.92	8.112%	33.30	7.697%	33.74	1.321%	36.95	9.514%	36.95	N/A	29.20%
12	29.10	31.46	8.110%	33.88	7.692%	34.33	1.328%	36.95	7.632%	36.95	N/A	26.98%

	all lines	single-line	single-line increase	single-line	single-line increase	single-line	single-line increase	single-line	single-line increase	single-line	single-line increase	Total single-line increase
RG	1/15/2000	1/15/2000	1/15/2000	1/19/2001	1/19/2001	2/2/2001	2/2/2001	1/19/2002	1/19/2002	2/16/2002	2/16/2002	1/15/00 - 2/16/02
1	19.80	19.80	N/A	19.80	N/A	20.11	1.566%	20.11	N/A	20.46	1.740%	3.33%
2	20.80	20.80	N/A	20.80	N/A	21.12	1.538%	21.12	N/A	21.49	1.752%	3.32%
3	21.90	21.90	N/A	21.90	N/A	22.24	1.553%	22.24	N/A	22.63	1.754%	3.33%
4	22.90	22.90	N/A	22.90	N/A	23.25	1.528%	23.25	N/A	23.66	1.763%	3.32%
5	23.85	23.85	N/A	23.85	N/A	24.22	1.551%	24.22	N/A	24.65	1.775%	3.35%
6	24.90	24.90	N/A	24.90	N/A	25.29	1.566%	25.29	N/A	25.73	1.740%	3.33%
7	25.75	25.75	N/A	25.75	N/A	26.15	1.553%	26.15	N/A	26.61	1.759%	3.34%
8	26.60	26.60	N/A	26.60	N/A	27.01	1.541%	27.01	N/A	27.49	1.777%	3.35%
9	27.40	27.40	N/A	27.40	N/A	27.82	1.533%	27.82	N/A	28.31	1.761%	3.32%
10	28.00	28.00	N/A	28.00	N/A	28.43	1.536%	28.43	N/A	28.93	1.759%	3.32%
11	28.60	28.60	N/A	28.60	N/A	29.04	1.538%	29.04	N/A	29.55	1.756%	3.32%
12	29.10	29.10	N/A	29.10	N/A	29.55	1.546%	29.55	N/A	30.07	1.760%	3.33%

6 rate increases in 2 years
 15 % rate increases each year
 Business line rate increases approx every 4 months of 5.2%

CERTIFICATE OF SERVICE

I hereby certify that a copy of the foregoing was sent by e-mail and regular mail to the persons listed below, other than those marked with an (*) who have been sent a copy via overnight mail, this 25 day of November, 2002.

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A handwritten signature in black ink, appearing to read "Matthew Feil", written in a cursive style.

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