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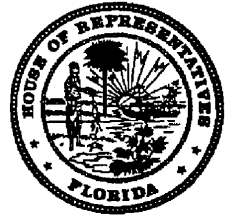
PRESIDENT



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November 19, 2003

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Re: Docket Nos. 030867-TL, 030868-TL & 030868-TL

Dear Ms. Bayo:

Enclosed for filing in the above-referenced docket are original and 15 copies of the Rebuttal Testimony of Dr. David J. Gabel.

Please indicate the time and date of receipt on the enclosed duplicate of this letter and return it to our office.

Sincerely,

*Charles J. Beck*  
Charles J. Beck  
Deputy Public Counsel

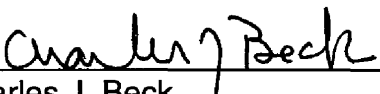
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**CERTIFICATE OF SERVICE**

I HEREBY CERTIFY that a copy of the foregoing Rebuttal Testimony of Dr. David J. Gabel has been furnished by U.S. Mail, hand-delivery and/or overnight delivery to the following parties on this 19th day of November, 2003.

  
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**BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION  
TALLAHASSEE, FLORIDA**

**IN THE MATTER OF  
THE PETITIONS OF VERIZON FLORIDA INC.,  
BELLSOUTH TELECOMMUNICATIONS INC., AND SPRINT-FLORIDA INC.  
TO REFORM THEIR INTRASTATE NETWORK ACCESS  
AND BASIC LOCAL TELECOMMUNICATIONS RATES  
IN ACCORDANCE WITH FLORIDA STATUTES, SECTION 364.164**

**DOCKET NOS. 030867-TL, 030868-TL, 030869-TL**

**REBUTTAL TESTIMONY OF  
DR. DAVID J. GABEL  
ON BEHALF OF  
THE OFFICE OF PUBLIC COUNSEL (OPC)**

**NOVEMBER 19, 2003**

DOCUMENT NUMBER 11648

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FLORIDA PUBLIC SERVICE COMMISSION

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1 **1 Introduction And Witness Background**

2

3 **Q. Please state your name and business address.**

4 A. My name is David Gabel. My business address is 31 Stearns Street,  
5 Newton, Massachusetts 02459-2441.

6

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

8 A. I am appearing on behalf of the Florida Office of Public Counsel (OPC).

9

10 **Q. Are you the same individual that submitted direct testimony in this**  
11 **proceeding on behalf of the Florida Office of Public Counsel (OPC)?**

12 A. Yes.

13

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

15 A. The purpose of my rebuttal testimony is to address the direct testimony of:  
16 Dr. Mayo,<sup>1</sup> on behalf of AT&T Communications of the Southern States, LLC  
17 ("AT&T") and MCI Worldcom Telecommunications, Inc. ("MCI"); Mr. Fonteix,<sup>2</sup> on  
18 behalf of AT&T; Mr. Shafer,<sup>3</sup> and Ms. Ollila,<sup>4</sup> on behalf of staff for the Florida

---

<sup>1</sup> Direct Testimony of Dr. John W. Mayo on behalf of AT&T Communications of the Southern States, LLC and MCI Worldcom Communications, Inc., October 31, 2003.

<sup>2</sup> Direct Testimony of Mr. Wayne Fonteix on behalf of AT&T Communications of the Southern States, LLC, October 31, 2003.

<sup>3</sup> Direct Testimony of Mr. Gregory L. Shafer on behalf of Staff for the Florida Public Service Commission, October 31, 2003.

1 Public Service Commission ("the Commission"); and Mr. Boccucci, Jr., on behalf  
2 of Knology of Florida, Inc. ("Knology").<sup>5</sup> I will address several issues in my  
3 rebuttal testimony, referring to the testimony of: Dr. Mayo on competitive pricing;  
4 Dr. Mayo and Mr. Fonteix on residential basic local telephone service (BLTS),  
5 support and entry; Mr. Shafer on legislative intent, entry and bundled and long  
6 distance rates; Ms. Ollila on the "Competition Report";<sup>6</sup> and Mr. Boccucci, Jr. on  
7 BLTS support and competitive entry.

8

9 **Q. Can you succinctly summarize the positions of AT&T, MCI, Staff and**  
10 **Knology as stated in the testimony of their expert witnesses and your**  
11 **responses to these positions?**

12 A. Yes. AT&T and MCI:

13

- 14 ♦ assert that BLTS rates are subsidized;
- 15 ♦ are concerned that existing access prices prevent competitive local  
16 exchange carriers (CLECs) from competing retail long distance prices  
17 down toward costs, and from competing through the supply of bundles;

---

<sup>4</sup> Direct Testimony of Ms. Suzanne M. Ollila on behalf of Staff for the Florida Public Service Commission, October 31, 2003.

<sup>5</sup> Direct Testimony of Mr. Felix L. Boccucci Jr. on behalf of Knology, Inc., October 31, 2003.

<sup>6</sup> Florida Public Service Commission's, Office of Market Monitoring and Strategic Analysis, "Telecommunications markets in Florida: Annual Report on Competition as of June 30, 2002" December 2002.

- 1       ♦ recommend that regulation should emulate prices that would emerge in a  
2       competitive market, a position consistent with that of the OPC, but that the  
3       proposed BLTS prices are correct, and that access services should be  
4       priced at incremental cost.

5

6       It is the OPC's view that:

7

- 8       ♦ AT&T and MCI present no evidence that BLTS is subsidized or that the  
9       proposed rate rebalancing is consistent with competitive prices (and note,  
10      Staff do not present any evidence or findings on whether BLTS or  
11      residential BLTS is subsidized); and

- 12      ♦ AT&T's and MCI's view on what they believe constitute correct BLTS and  
13      access service prices is inconsistent with competitive practice.

14

15      Mr. Shafer argues that if residential BLTS is subsidized, then entry would be  
16      difficult, but this conclusion does not hold if BLTS is an important complement to  
17      other services (as Mr. Shafer points out in his testimony) or is supplied as part of  
18      a bundle.

19

20      Knology claims that the rebalancing will generate competitive entry, but in no way  
21      demonstrates this, and indeed its testimony appears to contradict its position in a  
22      filing with the Securities and Exchange Commission.



1

2 **2 Rebuttal Of The Testimonies Of Dr. Mayo, A Witness For AT&T And**  
3 **MCI, And Mr. Fonteix, A Witness For AT&T**

4

5 **2.1 Dr. Mayo And Mr. Fonteix Provide No Evidence On Whether**  
6 **Residential BLTS Is Subsidized Or Supported**

7

8 **Q. What are your views of Dr. Mayo's and Mr. Fonteix's statements**  
9 **about whether residential BLTS is subsidized or supported?**

10 **A. Mr. Fonteix asserts, without providing any supporting evidence, that BLTS**  
11 **is subsidized.<sup>7</sup> Dr. Mayo claims, again absent evidence, that BLTS is supported.<sup>8</sup>**

12

13 **Q. Why is it important to provide evidence?**

---

<sup>7</sup> Fonteix Direct, p. 2, lines 15-18, p. 4, lines 2-4. Mr. Fonteix does not define subsidized and cites Mayo *ibid.* as supplying evidence of this without providing a specific location in that testimony. Mayo only once uses the language of subsidy in this context (Mayo, p. 15, lines 3-10), arguing that cross-subsidies prevent entry, but providing no evidence of a cross-subsidy—see also footnote 8 below. Moreover, the view that cross-subsidies prevent entry is in general incorrect—see my discussion on entry below on pp. 8 ff. (Section 2.2).

<sup>8</sup> Mayo Direct, p. 11. Mayo provides no definition of support or evidence that BLTS rates are supported or subsidized, but does argue that BLTS rates are inefficient because of the history of regulatory development (p. 8, lines 6-17, p. 9, lines 1-16). His only evidence to this effect is a paper published 7 years ago (p. 5, footnote 5), presumably written even earlier and based on evidence collected at least a year earlier, so hardly applicable to Florida in 2003. In any case, inefficient rates do not imply supported rates. On Dr. Mayo on "cross-subsidy", see footnote 7 above. Dr. Mayo also provides no support for his view that the proposed rebalancing "unequivocally 'removes support for basic local telecommunications services' in Florida... Thus, it is quite clear that the statutory requirement of removing support for basic local services will be met by the plan described in the ILECs' petitions" (Mayo Direct, p. 11, lines 11-12 and lines 16-17).

1 A. As a general matter, the Commission should not rely on the unsubstantiated  
2 opinion of an expert. An expert should provide a foundation for his/her  
3 conclusion.<sup>9</sup> Neither Mr. Fonteix nor Dr. Mayo have provided any evidence to  
4 support a finding that residential BLTS is subsidized or supported.<sup>10</sup> The material  
5 presented by Dr. Mayo and Mr. Fonteix on these points adds nothing to what was  
6 said by the ILECs' witnesses. In particular, their testimony does not show  
7 residential BLTS rates are currently priced below total service long run  
8 incremental cost.

9

10 **Q. You say that Dr. Mayo and Mr. Fonteix provide no evidence for their**  
11 **positions on whether BLTS is subsidized or supported. Is it possible that**  
12 **Dr. Mayo and Mr. Fonteix relied on the results submitted by the ILECs?**

13 A. It is possible but would contradict AT&T's view of the relevant economic  
14 costs. AT&T has routinely asserted, for example, in unbundled network element  
15 (UNE) dockets, that ILEC evidence overstates costs and have argued that the  
16 true economic cost of service is lower than the costs estimated by regulatory  
17 Commissions. AT&T has also contended that the same cost estimates should be  
18 used for determining the cost of basic telephone service.<sup>11</sup> In this case, the

---

<sup>9</sup> *Daubert v. Merrell Dow Pharmaceuticals, Inc.*, 113 S.Ct. 2786 (1993).

<sup>10</sup> I have shown the residential BLTS is not subsidized: Direct Testimony of Dr. David J. Gabel on behalf of the Office of Public Counsel for the Florida Public Service Commission, October 31, 2003, *passim*.

1 ILECs used UNE prices to estimate the cost of BLTS. If AT&T was to rely on the  
2 ILECs' total element long run incremental cost (TELRIC) estimates it would imply  
3 to me that either it is reversing its position regarding what is the economic cost of  
4 service or that AT&T will select a number that rationalizes its position in a  
5 particular case. In any case, AT&T should not rely on TELRIC studies since they  
6 include shared costs (as pointed out in my direct testimony).<sup>12</sup>

7

8 **Q. Has AT&T provided the Commission with its estimate of the**  
9 **economic cost of the loop?**

10 A. Yes. for example in docket PSC-01-1181-FOF-TP, AT&T estimated the  
11 costs as ranging from \$5.25 to \$34.24 for BellSouth's service level 2 loops. If we  
12 take AT&T's loop estimate for the lowest cost zone, \$5.25, and add on the cost of  
13 switching, transport, and retail incremental costs (approximately \$3.00) we get a  
14 cost estimate of \$8.25 that is significantly less than the ILECs' TELRIC-based

---

<sup>11</sup> AT&T sponsored the Hatfield Model in DOCKET NO. 960833-TP, order released December 31, 1996. The Commission order in that proceeding notes that the proponents of the Hatfield Model "purport that the model develops forward-looking network investments and costs for unbundled network elements and basic local exchange service." *Id.* Furthermore, AT&T has regularly argued that the economic cost of service is lower than the rates proposed by the ILECs and established by the Commission. See, for example, in docket PSC-01-1181-FOF-TP, AT&T contended that the economic cost of a loop was in the range of \$6.76 to \$8.00, or approximately one-half the rate established by the Commission. Table A, May 25, 2001. If a subsidy analysis was done by AT&T using what it has represented is the correct economic cost of service, it would have estimated that the cost of providing BLTS that was lower than the values identified by the ILECs. This, in turn, would have reduced the likelihood of a finding that residential service is supported or subsidized.

<sup>12</sup> Gabel Direct, at p. 11, lines 8-10.

1 estimate for the lowest cost zone of (approximately) \$20.<sup>13</sup> This is also less than  
2 residential BLTS charges of \$20.24. Therefore, it is unclear how Dr. Mayo  
3 concludes that BLTS is supported.

4

5 **Q. Perhaps Dr. Mayo's endorsement of raising BLTS rates is based on**  
6 **his belief that it is appropriate to raise residential rates to make up for any**  
7 **ILEC access revenue loss?**

8 A. I would be surprised if that was his view. In a recent Massachusetts  
9 proceeding, Dr. Mayo stated that it would be "unjust and unreasonable" to link  
10 access price reductions with an offsetting increase in the price of basic  
11 residential service.<sup>14</sup>

12

13 **Q. Perhaps AT&T believes that when testing for the existence of a**  
14 **subsidy or the degree of support it is appropriate to use UNE rates to**  
15 **prevent a price squeeze?**

16 A. AT&T's witnesses claim that BLTS is subsidized or supported. The  
17 economic test for determining if BLTS is subsidized involves comparing the  
18 ILEC's BLTS price with the ILEC's total service long-run incremental cost for  
19 BLTS. A price squeeze test is irrelevant to determining the existence of a

---

<sup>13</sup> The difference between the BellSouth cost estimate and the \$8.25 value is only partially attributable to retail costs.

<sup>14</sup> *Verizon - Massachusetts, Price-Cap Regulation*, Massachusetts Department of Telecommunications and Energy, DTE 01-31, Phase II, Department of Telecommunications and Energy, October 24, 2002, Vol. 3, pp. 290-293.

1 subsidy because the price squeeze test involves consideration of the CLEC's  
2 costs, rather than the ILEC's costs. It is the ILEC's costs that are of relevance in  
3 this proceeding because of the legislative requirement to consider the degree to  
4 which ILEC rates are subsidized or supported.

5

6 **2.2 Dr. Mayo And Mr. Fonteix Do Not Provide A Coherent Explanation**  
7 **Or Evidence As To Why The Proposed Rebalancing Would Induce**  
8 **CLEC Entry**

9

10 **Q. Please summarize Dr. Mayo and Mr. Fonteix views on the impact of**  
11 **current and rebalanced prices on entry. What is your view of their**  
12 **positions?**

13 A. Both Dr. Mayo and Mr. Fonteix contend that current prices prevent entry,<sup>15</sup>  
14 and that the proposed rebalancing will lead to more entry.<sup>16</sup> However, their  
15 arguments are moot to the extent that they rely on the rebalancing moving BLTS  
16 rates from below TSLRIC to above it (since there is no record evidence that  
17 BLTS is priced below TSLRIC).

18

---

<sup>15</sup> Mayo Direct, p. 12, lines 4-6; pp. Fonteix Direct, p. 2, lines 19-23, p. 3, lines 1-11.

<sup>16</sup> Mayo Direct, p. 11, lines 19-23, p. 12, lines 1-8, p. 14, lines 1-4, and p. 18, lines 3-5; Fonteix Direct, p. 5, lines 8-13, p. 7 lines 4-9 (note the provided example in this last case shows entry prior to, rather than caused by, access rate reductions), and p. 7, lines 14-16; implicit in p. 2, lines 19-23, p. 3, lines 1-11.

1 Further, despite arguing that retail telecommunications firms increasingly, and  
2 indeed necessarily, must compete through the supply of bundles,<sup>17</sup> neither Dr.  
3 Mayo nor Mr. Fonteix discuss the impact of rebalancing on revenues a CLEC  
4 might earn in bundling local long distance service and any other services, let  
5 alone total revenues a CLEC could expect to earn, including revenues from intra-  
6 LATA access charges.

7

8 Yet, such revenues, most importantly, total revenues from the broad range of a  
9 CLEC's operations would not be significantly changed because the proposed  
10 rebalancing is required to be revenue neutral and intra-LATA access charge  
11 savings must be passed on in retail long distance prices.<sup>18</sup> Consequently, from  
12 the perspective of expected total profitability, the proposed rebalancing will not  
13 have a substantial impact on entry incentives.<sup>19</sup>

14

15 I also note that Mr. Fonteix's presents evidence from other states that he claims  
16 shows that the proposed rebalancing would lead to more entry.<sup>20</sup> However, the  
17 evidence he presents has little if any bearing on this question. No meaningful  
18 conclusions can be drawn by comparing different states and/or time periods

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<sup>17</sup> For example, see Mayo Direct, p. 12, lines 18-22; Fonteix Direct, p. 2, line 23, p. 3, line 1; p. 5, lines 17-21, p. 6, line 1; p. 8, lines 12-13; and implicitly at p. 12, lines 18-20. Staff also take this view, for example, see footnote 63 below.

<sup>18</sup> For example, see Gabel Direct, Section 4.

<sup>19</sup> These comments apply specifically to Mayo Direct, p. 11, lines 19-23, p. 12, lines 1-8 and lines 18-21, p. 15, lines 1-14; references for Fonteix are as in footnote 17 above.

1 without an adequate statistical analysis that controls for the factors that differ  
2 from state to state and from one period of time to the next.<sup>21</sup>

3

4 It is also odd that AT&T would represent that high access fees are harmful to the  
5 CLECs when the CLECs have typically supported high access fees,<sup>22</sup> and the  
6 FCC has had to issue orders requiring the CLECs to lower their access fees.<sup>23</sup>

7

8 **Q. Have Dr. Mayo and Mr. Fonteix added any arguments on entry not**  
9 **adduced by the ILECs' witnesses? If so, please indicate your view of**  
10 **these.**

11 A. Yes, Dr. Mayo and Mr. Fonteix raise some lines of reasoning not made by  
12 the ILECs' witnesses, in particular that:

13

- 14 ♦ efficient entry may be precluded due the difference between the ILECs'  
15 physical cost of supply of intra-LATA calls and its access prices for the  
16 same; and  
17 ♦ the prospect of anti-competitive behavior on the part of the ILECs.

---

<sup>20</sup> Fonteix Direct, pp. 12-13.

<sup>21</sup> See Gabel Direct, Section 5, especially pp. 67-69.

<sup>22</sup> Discussed below, on pp. 8 and also footnotes 103 and 104.

<sup>23</sup> FCC 01-146 (CC docket Number 96-262), Seventh Report And Order And Further Notice Of Proposed Rulemaking, Adopted: April 26, 2001 (Released: April 27, 2001).

1  
2 On the first matter, Dr. Mayo makes two points. First, he thinks that high intra-  
3 LATA access rates mean CLECs “face asymmetrically higher costs” than the  
4 ILEC,<sup>24</sup> making it impossible for CLECs to press price to actual cost, but only to  
5 their perceived cost, the intra-LATA access rate.<sup>25</sup> Secondly, Dr. Mayo argues  
6 that high intra-LATA access rates make it impossible for the CLEC to bundle  
7 retail services, and in particular offer very low priced retail intra-LATA calls  
8 competitively with the ILEC, since the CLECs are said to face intra-LATA access  
9 prices that exceed the incremental cost of supplying intra-LATA calls, so the  
10 ILEC’s costs are lower than the CLEC’s.<sup>26</sup> Mr. Fonteix expresses a similar view.<sup>27</sup>

11

12 Both of these arguments are wrong for two reasons:

13

14 1. CLECs earn as well as pay termination charges.<sup>28</sup> Moreover, the intra-  
15 LATA termination charge incurred by the CLEC will on average net out—

---

<sup>24</sup> Mayo Direct, p. 13, line 2.

<sup>25</sup> Mayo Direct, p. 12, lines 22-23, p. 13, line 1-10.

<sup>26</sup> Mayo Direct, p. 13, lines 11-23 and p. 14, line 1.

<sup>27</sup> “[E]xcess access charges further depress competition by limiting competitors’ ability to compete across the full range of service categories,” Fonteix Direct, p. 2, lines 21-22 (but see also 19-20). As with Dr. Mayo, Mr. Fonteix’s argument is that higher intra-LATA access charges force competitors to charge higher retail rates for such calls, but that the ILECs do not incur such costs, so can compete at much lower prices, especially through bundles (Fonteix Direct, p. 2, line 23, p. 3, lines 1-11; on how undoing this alleged source of a price squeeze is said to improve outcomes see p. 5, lines 8-13, and p. 7, lines 14-16).

<sup>28</sup> The argument here also applies to origination charges for recipient pays calls.



1 so long as calls are reasonably random, even a very small network's  
2 outbound traffic will match in bound traffic—but even if they do not, net  
3 payments will be substantially less than gross payments and a very small  
4 proportion of the CLEC's total costs. As a result, moderately high  
5 termination charges do not represent a high total cost, most especially one  
6 that could prevent make bundling, even with very low or even zero rates  
7 on retail calls, unprofitable.

8  
9 2. While the termination rate, being a real marginal cost to the CLEC, is  
10 relevant to the CLEC's retail pricing decision, this will not prevent the  
11 CLEC from bundling with low rates on retail calls, if this is what the market  
12 demands (as both Mayo and Fonteix suggest).<sup>29</sup> Competitive markets  
13 often set rates above or below marginal cost as is necessary, most  
14 especially (but not necessarily) on "gateway" goods, such as retail line  
15 rentals,<sup>30</sup> and on items supplied as part of a bundle (for example, BLTS as  
16 part of a bundle with long distance service).<sup>31</sup> In these circumstances, the  
17 relevant cost to the supplier is, respectively, the cost of the gateway and  
18 the expected cost of products bought through the gateway ("such as caller

---

<sup>29</sup> See footnote 17 above.

<sup>30</sup> Shafer uses the term (Shafer Direct, p. 8, line 10) and defines at lines 11-15. The relevant quote is reproduced below on p. 8, where I also discuss pricing in this context.

1 ID, long distance service, or dial-up Internet access”),<sup>32</sup> or the bundle. In  
2 short, the cost of the bundle should be compared with its revenues.

3

4 **2.3 AT&T’s Position On Price Setting In This Case Is Inconsistent With**  
5 **Dr. Mayo’s Own Testimony As Well As How AT&T Sets Its Own**  
6 **Prices In Competitive Markets**

7

8 **Q. Dr. Mayo argues regulated prices should be reflective of prices in**  
9 **competitive markets.<sup>33</sup> What are your views on this?**

10 A. An important aspect of my earlier testimony was the view, “that  
11 rebalancing, if it occurs, should result in prices that reflect the operations of a  
12 competitive market, rather than prices that are sustainable due to a lack of  
13 competition.”<sup>34</sup> Dr. Mayo takes a very similar stand:

14

15 “it is important to note that price regulation is a substitute for rates  
16 set by competitive market forces. That is, economists commonly  
17 recommend that the rate setting exercise should, insofar as

---

<sup>31</sup> For a more general discussion on goods that complement others, see Gabel Direct, Section 4.3, pp. 61 ff. Note such bundles typically rendered profitable by a hefty monthly charge and high marginal prices for call minutes beyond a certain level.

<sup>32</sup> Shafer Direct, p. 8, lines 13-14.

<sup>33</sup> Mayo Direct, at p. 7, lines 14-17.

<sup>34</sup> Gabel Direct, at p. 11, lines 8-10.

1 possible, try to establish rates that mimic the rates that would be  
2 set by competitive market forces.”<sup>35</sup>

3  
4 **Q. In your view are Dr. Mayo’s recommendations—that residential BLTS**  
5 **prices should not be subsidized**<sup>36</sup> **(recognizing you have shown that**  
6 **residential BLTS is not subsidized) and that usage prices, such as intra-**  
7 **LATA access charges, should be set to exactly cover their LRIC**<sup>37</sup>**—**  
8 **consistent with prices that would emerge due to competitive market**  
9 **forces?**

10 A. No. As I noted in my testimony, it is common in competitive markets for  
11 prices, such as those for residential BLTS, to be kept low, sometimes even below  
12 their long run incremental cost (LRIC), and for usage charges to be set above  
13 LRIC to recover subsidies, where they occurred, and make any necessary  
14 contribution to fixed costs.<sup>38</sup>

15  
16 This is well evidenced by AT&T’s own pricing behavior in competitive mobile  
17 telecommunications markets. For example, AT&T typically offers free and

---

<sup>35</sup> Mayo Direct, at p. 7, lines 14-17.

<sup>36</sup> See, for example, Mayo Direct, p. 14, lines 17-19, p. 15, lines 1-14.

<sup>37</sup> Mayo Direct, p. 20, lines 8-11: “The relevant target, however, for the establishment of competition-enabling intrastate switched access charges in Florida is the economically efficient rate as approximated by incremental cost.”

<sup>38</sup> For example, because of the gateway nature of the service—see footnote 30 above, and more generally footnote 31.

1 heavily subsidized mobile telephone handsets to new subscribers, thereby  
2 pricing handsets below their incremental cost. On 9 November 2003, AT&T  
3 offered three different handsets for free to new subscribers.<sup>39</sup> Mobile firms also  
4 typically offer handsets at below cost prices, even when a price is charged. For  
5 example, the AT&T cited web page that offers the Nokia 3560 handset for free  
6 indicates its normal price is \$99.99. However, if bought directly from Nokia, the  
7 handset is priced at \$139.99.<sup>40</sup> In either case, it is likely that AT&T prices the  
8 handset well below its LRIC.<sup>41</sup> Of course, AT&T expects, on average, to recover  
9 the cost of such discounts through subsequent usage charges which exceed the  
10 incremental cost of supplying that usage.

11

12 **Q. Please comment on Dr. Mayo's views on the right level for intra-LATA**  
13 **and inter-LATA access rates.**

14 A. Dr. Mayo concludes his testimony:

15

16 "My understanding is that interstate access charge rates continue  
17 be set at rates that exceed the economic cost of providing access.

18 The relevant target, however, for the establishment of competition-

---

<sup>39</sup>

<http://www.attwireless.com/personal/products/phones.jhtml;dsessionid=KOY5BO1NV4SB3B4R0GZSFFA?titleNumber=2&requestid=75073>.

<sup>40</sup> <http://www.nokiausa.com/phones/3560>.

1 enabling intrastate switched access charges in Florida is the  
2 economically efficient rate as approximated by incremental cost.”<sup>42</sup>

3  
4 Such a conclusion cannot be reached, as Dr. Mayo does, by merely comparing  
5 price to incremental cost. Rather, total earnings of the ILEC must be considered,  
6 as well as evidence on demand elasticities. A competitive carrier, to be  
7 successful in the long run, must cover its costs. In telecommunications, costs  
8 include a substantial fixed component,<sup>43</sup> which pricing at incremental costs would  
9 not cover. Consequently, service prices typically must exceed their long run  
10 incremental cost. In a competitive market, carriers would be pressured to ensure  
11 the necessary mark-up over long run incremental cost minimizes harm to their  
12 consumers. In particular, mark-ups would be made taking account of firm level  
13 demand elasticities. As I have indicated,<sup>44</sup> this typically implies, for example, low  
14 prices on “gateway” services such as line rentals.

---

<sup>41</sup> Since the retail price is \$139.99, this is the opportunity cost to AT&T, which does not manufacture the handset, but could resell it at the retail rate.

<sup>42</sup> Mayo Direct, p. 20, lines 7-11.

<sup>43</sup> See, for example, on loop costs, FCC, 03-36 (Triennial Review Order), Report And Order And Order On Remand And Further Notice Of Proposed Rulemaking, February 20, 2003 (released August 21, 2003), paragraph 205.

<sup>44</sup> See footnote 30 above, and more generally, including the case of bundling, see footnote 31.

1 **3 Staff Witness Mr. Shafer On Legislative Intent, Entry And Bundled And**  
2 **Long Distance Rates**

3

4 **3.1 The Legislation In No Way Presumes BLTS Is Supported**

5

6 **Q. Can you comment on Mr. Shafer's views on the theoretical**  
7 **underpinnings/premises of the Act?**

8 **A. Yes. Mr. Shafer claims, without evidence, that:**

9

10 "the theoretical underpinnings of the statute are that the cost/price  
11 relationships for intrastate access charges and basic local service  
12 rates are seriously misaligned. More simply put, the Legislature  
13 subscribed to the notion that access charges subsidize basic local  
14 rates, or that access charge rates far exceed cost and basic local  
15 service rates are on average below cost."<sup>45</sup>

16

17 and that:

18

---

<sup>45</sup> Shafer Direct, p. 7, lines 5-11.

1           “The premise under which the Legislature passed the Tele-  
2           competition Act is that basic local service rates are subsidized by  
3           intrastate access charges.”<sup>46</sup>

4  
5           The Act, however, appears agnostic on this, directing the Commission to  
6           consider rebalancing more favorably if it were to “remove current support for  
7           basic local telecommunications services (BLTS) that prevents the creation of a  
8           more attractive competitive local exchange market for the benefit of residential  
9           customers; [and] [i]nduce enhanced market entry.”<sup>47</sup>

10  
11           **3.2       Mr. Shafer Takes No View As To Whether BLTS Or Residential**  
12           **BLTS Is Supported**

13  
14           **Q.       What are Mr. Shafer’s views on whether BLTS is priced below cost or**  
15           **otherwise supported and does he provide any evidence on the question?**

16           A.       Mr. Shafer does not directly say that BLTS is priced below cost or  
17           otherwise supported and supplies no evidence that this is the case. He makes  
18           no

---

<sup>46</sup> Shafer Direct, p. 16, lines 6-8.

<sup>47</sup> Section 364.164 (1) (a) and (b).

1 direct or implied comments on whether residential BLTS is subsidized. My direct  
2 testimony demonstrates that the available evidence indicates that residential  
3 BLTS is not cross-subsidized.<sup>48</sup>

4

5 **3.3 Mr. Shafer Is Incorrect In Asserting That If BLTS Was Priced Below**  
6 **Cost This Would Necessarily Discourage Entry**

7

8 **Q. What are Mr. Shafer's views on entry if BLTS was priced below cost**  
9 **and do you agree with these views?**

10 A. Mr. Shafer incorrectly believes that:

11

12 "To the degree that basic local service rates are below cost, that is  
13 a significant deterrent to market entry for that particular service."<sup>49</sup>

14

15 And that:

16

17 "The challenge of making a profit in a market in which a key product  
18 is priced below cost is clearly a deterrent to entry."<sup>50</sup>

---

<sup>48</sup> Gabel Direct, *passim*.

<sup>49</sup> Shafer Direct, p. 6, lines 11-14.

<sup>50</sup> Shafer Direct, p. 6, lines 23-24. Shafer repeats these views in many places—see p. 6, lines 18-21, and lines 23-25, continued on p. 8, line 1, p. 9, lines 5-12, p. 10, lines 2-5, and p. 11, lines 13-17.



1

2 Mr. Shafer is not correct that prices in a competitive market cannot be below  
3 cost, most especially on, in Shafer's words, a "gateway good".<sup>51</sup> As Mr. Shafer  
4 points out:

5

6 "Many products cannot be viewed in isolation, and I believe basic  
7 local exchange access is one of those services. Basic local  
8 exchange service is a gateway product... it provides access to an  
9 array of other products or services that cannot stand alone or have  
10 no value without local exchange access. For example, services  
11 such as caller ID, long distance service, or dial-up Internet access  
12 are unavailable to consumers without local exchange service."<sup>52</sup>

13

14 In such cases, it is common for prices to be below cost without  
15 discouraging entry.<sup>53</sup> As Shafer puts it:

16

17 "The profitability of these other services ['such as caller ID, long  
18 distance service, or dial-up Internet access'] also plays a role in the  
19 market entry decision. This phenomenon also explains why some

---

<sup>51</sup> Shafer Direct, p. 8, line 10.

<sup>52</sup> Shafer Direct, p. 8, lines 8-15.

<sup>53</sup> As per discussion above associated with footnotes 30 and 31 (at p. 14).

1 residential competition persists even in light of the evidence that  
2 basic local exchange service on its own is priced below cost on  
3 average.”<sup>54</sup>

4

5 I add that residential BLTS is not subsidized based on my review of the  
6 data presented by the ILECs.<sup>55</sup> Consequently, even if Mr. Shafer were  
7 right that a subsidy prevents entry (and he is not), entry into residential  
8 BLTS would not be discouraged in present day Florida based upon the  
9 record evidence.

10

11 Moreover, on the question of entry, in Shafer’s words, “the primary factor  
12 for a competitor to consider is whether they will be profitable in the  
13 foreseeable future in any particular market”.<sup>56</sup> Yet, profitability of entry is  
14 not significantly changed by a revenue neutral price adjustment, thus the  
15 proposed rebalancing provides little or no incentive for increased entry.

16

17 Finally, even if the proposed rebalancing increased the profitability of  
18 entry, it does not automatically follow that new entry will occur. Given

---

<sup>54</sup> Shafer Direct, p. 8, lines 23-25, continued on p. 9, lines 1-2. The quote in square brackets is from p. 8, lines 13-14.

<sup>55</sup> Gabel Direct, *passim*.

1 sunk costs and other entry barriers, even higher profits may still be too low  
2 to result in significant new entry.

3

4 **Q. Did Mr. Shafer present evidence to support proposition that**  
5 **current rates are a significant deterrent to market entry?**

6 A. No, he did not. However, as I discuss below (1) Knology, Inc. in its SEC  
7 filings, does not list this as an impediment of entry or expansion;<sup>57</sup> (2) as is also  
8 the case for CLECs in a survey conducted by Staff;<sup>58</sup> and (3) CLECs generally  
9 consider lower access rates, even in return for higher BLTS charges, as having a  
10 negative impact on their profits.<sup>59</sup>

11

12 **Q. Does any other evidence from Staff provide insights into the drivers**  
13 **of CLEC entry?**

14 A. Yes, the 2002 "Competition Report" sponsored by Staff witness, Ms.  
15 Ollila, is relevant, and even more so, the "2003 Competition Report,"<sup>60</sup> containing  
16 similar, but more recent evidence.

---

<sup>56</sup> Shafer Direct, p. 7, lines 1-3. Note the question asked was, "What would be the basis for competitors choosing to enter markets they had previously elected not to enter?" (p. 6, lines 24-25).

<sup>57</sup> See below pp. 8 ff. and footnotes 94 and 95.

<sup>58</sup> See below pp. 8 ff. and footnote 96.

<sup>59</sup> See below pp. 8 ff. and footnotes 103 and 104.

<sup>60</sup> Florida Public Service Commission's, Office of Market Monitoring and Strategic Analysis, "Telecommunications markets in Florida: Annual Report on Competition as of June 30, 2003", revised draft, October 27, 2003; <http://www.psc.state.fl.us/general/publications/reports.cfm>.

1

2 **Q. Please summarize the 2002 Competition Report discussion of drivers**  
3 **of CLEC entry.**

4 A. The report's section on entry begins with the views of the regulatory  
5 commissions from the two states with the most CLEC entry, New York and  
6 Texas:

7

8 "The New York Commission stated that its ALEC market share may  
9 have been the result of the introduction of the UNE Platform... and  
10 the FCC's decision to allow Verizon to operate as a long distance  
11 carrier in New York (271 approval)...

12

13 "The Texas Commission provided several reasons for its relatively  
14 high ALEC market share: prevalence of UNE-P, 271 approval...,  
15 existence of a standard, 4-year interconnection agreement...,  
16 performance measures, uniform state-wide municipal right-of-way  
17 compensation, and building access regulation."<sup>61</sup>

18

---

<sup>61</sup> Competition Report, p. 25.

1 These are the only reasons given by the New York and Texas  
2 Commissions that the Report cites. In particular, neither Commission is  
3 cited as mentioning low BLTS rates.

4

5 The authors of the Florida Competition Report conclude that CLEC entry  
6 tends to rise with 271 approval, larger margins between UNE prices and  
7 retail prices, and lower differences in UNE rates across zones.<sup>62</sup>

8

9 It is the view of the OPC that these factors are important, but with an  
10 important caveat on the margin between retail and UNE rates: the  
11 appropriate margin should be measured by a comparison of total  
12 revenues with the total cost of entry.<sup>63</sup> For example, retail supply through  
13 purchase of UNE-P entitles the supplying carrier to access charges and  
14 these must be accounted for. Consequently, a fall in access charges  
15 accompanied by a revenue neutral rise in BLTS rates is unlikely to have a  
16 substantial positive impact on the profitability of UNE-P entry.<sup>64</sup>

---

<sup>62</sup> Competition Report, pp. 25-26. Discussion is provided in pp. 26 ff. The 2003 Competition Report provides lists 10 factors that impact on CLEC entry decisions, including most of those already mentioned (pp. 13-14).

<sup>63</sup> This is recognized in the Report—"This analysis also does not include any additional margins that competitors could obtain by selling long distance and ancillary services such as voice mail, caller ID, call waiting, etc." (p. 29)—but not discussed in further detail, and is recognized more explicitly in the 2003 Competition Report—"Both ILEC and CLEC business plans depend on the average subscriber purchasing more than basic local service" (p. 18). For more on OPC's view that a broad view of entry decisions must be taken, see pp. 8 ff. (Section 2.2) above.

<sup>64</sup> See below pp. 8 ff. and footnotes 103 and 104.

1

2 **Q. Does the Competition Report present any evidence about**  
3 **actual CLEC entry in Florida?**

4 A. Yes, and this evidence strongly suggests that 271 approval and the  
5 availability of UNEs at affordable rate are central to CLEC entry decisions.

6 The Report indicates that important reductions in UNE rates occurred in  
7 May and October 2001, and then in September 2002.<sup>65</sup> At the time of  
8 writing the Report, only pre-September 2002 data was available, but on  
9 that basis, the Report concludes:

10

11 "the May and October 2001 rate changes have had a dramatic  
12 effect on the Florida market. The number of UNE-P lines in service  
13 in BellSouth's territory grew more than 259%."<sup>66</sup>

14

15 **Q. You indicated evidence that is more recent was available in the 2003**  
16 **Competition Report. Please summarize that evidence as it is relevant to**  
17 **the level of entry.**

---

<sup>65</sup> Competition Report, p. 34, especially Table 8; the change in May see p. 35.

<sup>66</sup> Competition Report, pp. 35-36, including Figures 14-16. My direct testimony also concluded that recent line growth had surged, and also attributed this to lower UNE prices (Gabel direct, pp. 41-42).

1 A. Substantial CLEC entry in Florida continued—"switched based lines...  
2 grew 34%... in the 2002-2003 reporting period."<sup>67</sup> In BellSouth's six major  
3 markets, CLEC penetration rates were 18%, 24%, 26%, 27%, 28%, and 28%.<sup>68</sup>

4  
5 **Q. Please comment on these rates.**

6 A. Several comments are relevant here. First, rapid growth in entry is hardly  
7 evidence of entry failure. Second, this rapid growth is no doubt in part explained  
8 by the September 2003 UNE rate reductions which left UNE-P prices at levels  
9 less than BLTS rates alone, that is, before accounting for other revenue  
10 sources.<sup>69</sup> Third, entry and market expansion decisions in telecommunications  
11 take substantial time. As a result, increased entry due to the September 2002  
12 changes will continue well beyond the impact reported at June 2003.

13  
14 **Q. You have indicated the 2003 Competition Report showed rapid rates  
15 of growth in entry levels. Did it contain any relevant evidence on the mix of  
16 entry?**

17 A. Yes. Even more striking than the rapid levels of entry, were three aspects  
18 of the mix of entry:

19

---

<sup>67</sup> 2003 Competition Report, p. 20; more generally see pp. 20 ff.

<sup>68</sup> 2003 Competition Report, p. 23, Table 9.

<sup>69</sup> 2003 Competition Report, p. 18.

1 (1) "[F]acility-base carriers have mainly targeted metropolitan areas,"<sup>70</sup> a trend  
2 unlikely to be significantly impacted by the proposed rebalancing.<sup>71</sup>

3  
4 (2) Entry occurred to a much greater extent in BellSouth territory than in areas  
5 serviced by Verizon and Sprint.<sup>72</sup> For example, whereas CLECs have  
6 penetration rates 18-28% in the major markets served by BellSouth's  
7 exchanges, they only have 6-18% of Verizon's markets, and 11% of  
8 Sprint's.<sup>73</sup>

9  
10 (3) "UNE-P only comprises 3% of CLEC lines in Verizon's territory and only  
11 5% in Sprint's," but 48% of BellSouth lines.<sup>74</sup>

12  
13 **Q. Is it likely that the ILECs' petitions, on their own, would change the**  
14 **mix of entry?**

15 **A.** No, not at all. The petitions are intended to be revenue neutral, so they  
16 would have a very limited impact on the relative attractiveness of entry into one

---

<sup>70</sup> 2003 Competition Report, p. 21; see also p. 15.

<sup>71</sup> David Gabel, "Why is There So Little Competition in the Provision of Local Telecommunications Services? An Examination of Alternative Approaches to End-User Access," MSU-DCL Law Review, 2002, 651-670.

<sup>72</sup> 2003 Competition Report, pp. 22 ff.

<sup>73</sup> 2003 Competition Report, p. 23, Table 9.

<sup>74</sup> 2003 Competition Report, p. 16.



1 ILEC's market over another's. They would also have little impact on the choice  
2 of UNE-P over other means of entry.

3

4 **Q. Does the 2003 Competition Report suggest any likely causes of the**  
5 **sharply different rates entry into different ILEC territories?**

6 A. Yes. The 2003 Competition Report explains the difference in CLEC entry  
7 rates in a manner similar to the New York Commission:<sup>75</sup> the availability UNEs at  
8 reasonable prices and the 271 process appear to be crucial to CLEC entry.<sup>76</sup> For  
9 example, the Florida Commission has only recently set UNE prices for Sprint and  
10 Verizon, and the Verizon rates have been stayed by a court order, while the  
11 Sprint rates only just came into effect, so have not yet affected penetration  
12 rates,<sup>77</sup> though ten new entrants now operate in Sprint territory.<sup>78</sup>

13

14 **Q. What is the OPC's view of this question?**

15 A. The OPC concurs that the chief causes of CLEC entry in Florida have  
16 likely been the 271 process,<sup>79</sup> and the availability of permanent cost-based UNE  
17 prices at levels that make profitable entry feasible. As a consequence, it is likely

---

<sup>75</sup> See p. 8 above.

<sup>76</sup> 2003 Competition Report, pp. 14-16.

<sup>77</sup> 2003 Competition Report, p. 16.

<sup>78</sup> 2003 Competition Report, p. 18.

<sup>79</sup> In part because it forces inter-exchange carriers to compete through bundles, and in part because the ILEC, in seeking the right to retail long distance services in its own territory, provides a range of competitive guarantees, including UNE availability.

1 that entry will continue in the BellSouth territories, and likely will grow in Sprint's  
2 areas of operation. Entry in Verizon's territory, however, may remain stalled  
3 while UNE prices are a matter of court proceedings.

4

5 **Q. Can you discuss Mr. Shafer's views on bundled service offerings,**  
6 **and pricing of long distance services, especially by wireless carriers?**

7 A. Yes. Mr. Shafer claims:

8

9 "achieving parity between intrastate access charges and interstate  
10 access charges will lead to more competitively priced bundled  
11 service offerings for residential consumers, which will provide  
12 benefits to those consumers whose calling patterns match those  
13 offerings."<sup>80</sup>

14

15 And later that:

16 "it is likely that there will be a significant number of residential  
17 consumers that will see benefits in expanded choice and new and  
18 innovative services."<sup>81</sup>

19

---

<sup>80</sup> Shafer Direct, p. 13, lines 5-9.

<sup>81</sup> Shafer Direct, p. 14, lines 11-14.

1 He also says that “a *significant number* of residential consumers... will see  
2 benefits in expanded choice and new and innovative services.”<sup>82</sup>

3

4 **Q. In your view, does Mr. Shafer support these strong claims?**

5 A. The only explanation Mr. Shafer offers for these claims seem  
6 related to wireless competition in long distance supply pressing down long  
7 distance rates and leading to lower wireline bundle prices.<sup>83</sup> Two points  
8 should be made here:

9

10 1. The statute requires that retail long distance suppliers pass on any  
11 reductions in intra-LATA access rates implemented in the proposed  
12 rebalancing. Therefore, assuming the law is appropriately implemented,  
13 no competitive pressure from wireless carriers is necessary for long  
14 distance rates to be lowered.

15

16 2. It may be that competition among wireless providers provides some link  
17 between total wireless firm revenues and costs. But the impact of  
18 Florida’s rebalancing on long distance prices, or bundled telephony prices  
19 in wireless, let along for the somewhat more distant substitute, wireline  
20 services, is likely to be quite small. Wireless pricing plans apply to wide

---

<sup>82</sup> Emphasis added. Shafer Direct, p. 14, lines 11-14.

<sup>83</sup> Shafer Direct, p. 13, lines 10-25, continued on p. 14, lines 1-6, and 15-24.

1 geographic areas, often at the national level. Consequently, lowering  
2 intra-LATA access rates in Florida are likely to have only a limited impact  
3 on prices of such plans.

4

5 Similarly, the price of wireless service is for a bundle of products—for  
6 example, as per Shafer, “the pricing strategy employed by wireless  
7 carriers... treats long distance minutes the same as local minutes”—so the  
8 effect would be further diluted.<sup>84</sup>

9

10 In this light, Mr. Shafer provides no evidence for proposing that “a *significant*  
11 *number* of residential consumers... will see benefits in expanded choice and new  
12 and innovative services,”<sup>85</sup> and indeed, admits that he doubts “that all residential  
13 consumers affected by the proposed rate changes will experience the benefits of  
14 increased competition and additional service offerings”<sup>86</sup> It is OPC’s view that  
15 better evidence than this is required to show consumers will benefit from the  
16 proposed rebalancing.

17

---

<sup>84</sup> Shafer Direct, p. 14, lines 4-6.

<sup>85</sup> Emphasis added. Shafer Direct, p. 14, lines 11-14.

<sup>86</sup> Shafer Direct, p. 14, lines 9-11.

1 **4 A Rebuttal Of The Testimony Of Mr. Boccucci, Jr.**

2

3 **4.1 Mr. Boccucci, Jr. Claims The ILECs' Petitions Will Increase**  
4 **Competitive Entry, But Provides No Material Evidence For This,**  
5 **And What He Says Is Inconsistent With Public Statements From**  
6 **Knology, Inc.**

7

8 **Q. Can you summarize Mr. Boccucci, Jr.'s testimony?**

9 A. Yes, Mr. Boccucci, Jr., in his own words, presents "the position of Knology  
10 of Florida, ("Knology"), a competitive local exchange carrier, in support of the  
11 petitions subject to this proceeding."<sup>87</sup> He concludes:

12

13 "Knology believes that the grant of these petitions will remove  
14 current support for basic local telecommunications services that  
15 prevents the creation of a more attractive competitive local  
16 exchange market for the benefit of residential consumers, will  
17 induce enhanced market entry and will create more capital  
18 investment and provide more employment in the State of Florida."<sup>88</sup>

19

---

<sup>87</sup> Boccucci Jr. Direct, p. 1, lines 7-9.

<sup>88</sup> Boccucci Jr. Direct, p. 11, lines 7-11.

1 **Q. Does Mr. Boccucci, Jr. show that that BLTS or residential BLTS are**  
2 **supported?**

3 A. No. Mr. Boccucci, Jr. nowhere demonstrates that BLTS or residential  
4 BLTS are supported. Moreover, I have shown that the record evidence indicates  
5 that residential BLTS is not subsidized.<sup>89</sup> Consequently, Mr. Boccucci, Jr.  
6 conclusions, which I quote in my answer to the preceding question, not only are  
7 not demonstrated, but do not follow as a matter fact.

8

9 **Q. Can you please highlight what you think is the central reason why**  
10 **you found no support of residential BLTS in contrast to the ILECs that**  
11 **found support (as also claimed by Mr. Boccucci, Jr.)?**

12 A. Yes. The basic reason for the difference between my estimates and those  
13 of the ILECs was the treatment of shared costs. The ILECs inappropriately  
14 included, in their BLTS costs estimates, costs shared by business and data  
15 services.

16

17 **Q. Does Knology, Inc. provide any insights into the treatment of shared**  
18 **costs and hence of the proper way to test for support or subsidy?**

19 A. Yes, it does. For example, the following quote is consistent with  
20 economic theory (and my position), but not the ILECS' cost studies; nor does it

---

<sup>89</sup> Gabel Direct, *passim*.

1 support Knology's claims that BLTS is supported. It states that shared costs  
2 should not be allocated when evaluating the profitability of a service:

3

4 "While management of the Company monitors the revenue  
5 generated from each of the various broadband services, operations  
6 are managed and financial performance is evaluated based upon  
7 the delivery of multiple services to customers over a single network.  
8 As a result of multiple services being provided over a single  
9 network, many expenses and assets are shared related to  
10 providing the various broadband services to customers.  
11 Management believes that any allocation of the shared expenses or  
12 assets to the broadband services would be subjective and  
13 impractical."<sup>90</sup>

14

15 **Q. What else did Mr. Boccucci, Jr. have to say on what would induce**  
16 **entry?**

17 A. Mr. Boccucci, Jr. testified that "Knology believes that Florida Statue  
18 364.164 creates the framework to promote facility-based local exchange  
19 competition";<sup>91</sup> that Knology, Inc. invests where the regulatory environment is

---

<sup>90</sup> Knology, Inc., 10-Q report, September 30, 2003, p. 8,  
<http://www.sec.gov/Archives/edgar/data/1096788/000119312503070040/d10q.htm>.

<sup>91</sup> Boccucci Jr. Direct, p. 2, lines 16-17.

1 favorable (which given its prior investment in Panama City,<sup>92</sup> presumably included  
2 the State of Florida) and that “[i]f these petitions are granted, Knology will be able  
3 to attract and deploy new capital investment in Florida, thereby offering  
4 consumers a choice in facilities-based providers for new and advanced high-tech  
5 services.”<sup>93</sup>

6

7 **Q. Is Mr. Boccucci, Jr.’s testimony on entry consistent with the**  
8 **information Knology, Inc. supplies to investors in its 10-K reports?**

9 A. No. In discussing impediments to entry, Knology, Inc. provided a range of  
10 difficulties that would adversely affect its operations.<sup>94</sup> None of these include too  
11 high access rates, too low BLTS rates, or existing legislation in any state.  
12 Similarly, none of these matters were raised in discussing difficulties in growing

---

<sup>92</sup> Boccucci Jr. Direct, p. 2, lines 21-23, this investment was made prior to June 2001 (see <http://www.knology.com/news/index.details.cfm?pkey=128>).

<sup>93</sup> Boccucci Jr. Direct, p. 9, lines 17-19.

<sup>94</sup> Knology, Inc., 10-K report, December 31<sup>st</sup>, 2002, p. 23.  
<http://www.sec.gov/Archives/edgar/data/1096788/000093176303000824/d10k.htm>:

“We may encounter difficulties expanding into additional markets, which could adversely affect our results of operations.

“To expand into additional cities we will have to obtain pole attachment agreements, construction permits, franchises and other regulatory approvals. Delays in entering into pole attachment agreements and in receiving the necessary construction permits and in conducting the construction itself have adversely affected our schedule in the past and could do so again in the future. Further, as we are currently experiencing in Louisville, we may face legal or similar resistance from competitors who are already in these markets. For example, a competitor may oppose or delay our franchise application or our request for pole attachment space. These difficulties could significantly harm or delay the development of our business in new markets.”



1 the company that would harm its operations.<sup>95</sup> Nor were these matters raised in  
2 Staff discussion of a survey of CLECs on impediments to entry. The top four  
3 concerns of CLECs, ranked starting with the often cited, were UNE rates,  
4 interconnection agreements, service outages and billing.<sup>96</sup>

5  
6 **Q. Does Mr. Boccucci, Jr. provide any evidence for his assertions on**  
7 **entry that you cite?**

8 A. Knology claims it was motivated by the Act to invest in Florida through the  
9 purchase of "Cable and Data Asset (Verizon Media) in Pinellas County,"<sup>97</sup> but  
10 provides no evidence to this effect, except for the timing of that purchase.

11  
12 **Q. Mr. Boccucci, Jr. testified that on entry by Knology "incumbent**  
13 **providers upgrade their networks... implement new products and price**  
14 **reductions and increase the level of customer service and marketing to**

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<sup>95</sup> Knology, Inc., 10-K report, December 31<sup>st</sup>, 2002, p. 25.  
<http://www.sec.gov/Archives/edgar/data/1096788/000093176303000824/d10k.htm>;

"Our ability to grow will depend, in part, upon our ability to:

- successfully implement our strategy;
- evaluate markets;
- secure financing;
- construct facilities;
- obtain any required government authorizations; and
- hire and retain qualified personnel."

<sup>96</sup> 2003 Competition Report, p. 56-57, including Figure 26.

<sup>97</sup> Boccucci Jr. Direct, p. 3, lines 9-11.

1 **compete with Knology.” Does this indicate that the proposed rebalancing**  
2 **will lead to CLEC entry?**

3 A. No, it does not. This is a standard result of competitive entry, but provides  
4 no indication of whether the proposed rebalancing encourages entry.

5  
6 **Q. Mr. Boccucci, Jr. testified that Knology actively bundles “voice,**  
7 **video and data services”<sup>98</sup> and provides “advanced or new services.”<sup>99</sup>**  
8 **Does this indicate that the proposed rebalancing promotes bundling and**  
9 **advanced or new services?**

10 A. No. According to Mr. Boccucci, Knology currently bundles and offers such  
11 services in Panama City, Florida<sup>100</sup> where it has been operating since at least  
12 June 2001,<sup>101</sup> so these decisions can hardly have been a result of the Act.  
13 Similarly, Knology's parent, Knology, Inc. provides these kinds of services in  
14 number of other locations outside of Florida,<sup>102</sup> that is, in jurisdictions where the  
15 Act does not apply.

16

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<sup>98</sup> Boccucci Jr. Direct, p. 5, lines 13-15.

<sup>99</sup> Boccucci Jr. Direct, p. 5, lines 19-23, continued on p. 6, lines 1-10.

<sup>100</sup> Boccucci Jr. Direct, p.5, lines 13-23, continued on p. 6, lines 1-10.

<sup>101</sup> <http://www.knology.com/news/index.details.cfm?pkey=128>

<sup>102</sup> Boccucci Jr. Direct, p. 4, lines 10-12.

1 **Q. You indicated that Mr. Boccucci, Jr. claims that rebalancing will be**  
2 **helpful to facility-based entrants. Were you surprised by Mr. Boccucci, Jr.**  
3 **testimony and if so why?**

4 A. Yes, I was surprised. Access rate reductions have been perceived to be  
5 not in the best financial interest of many CLECs.<sup>103</sup> Indeed, this is Knology's own  
6 position in its 10-K report to the Securities and Exchange Commission:

7

8 *"Access Charge Reform.* The FCC is in the process of reducing  
9 access charges imposed by local telephone companies for  
10 origination and termination of interstate long distance traffic. Overall  
11 decreases in local telephone carriers' access charges as  
12 contemplated by the FCC's access reform policies would likely put  
13 downward pricing pressure on our charges to domestic interstate  
14 and international long-distance carriers for comparable access.  
15 Changes to the federal access charge regime could adversely  
16 affect us by reducing the revenues that we generate from charges  
17 to domestic interstate and international long-distance carriers for  
18 originating and terminating interstate traffic over our  
19 telecommunications facilities."<sup>104</sup>

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<sup>103</sup> FCC 01-146, paragraph 27; Gabel Direct, p. 57-58, which cites Pre-Filed Testimony of F. Wayne Lafferty on Behalf of Cox Connecticut Telecommunications, L.L.C. given on June 3, 2003.

<sup>104</sup> Knology, Inc., 10-K report, December 31<sup>st</sup>, 2002, p. 19,  
<http://www.sec.gov/Archives/edgar/data/1096788/000093176303000824/d10k.htm>.

1

2 Q. Does this conclude your testimony?

3 A. Yes.