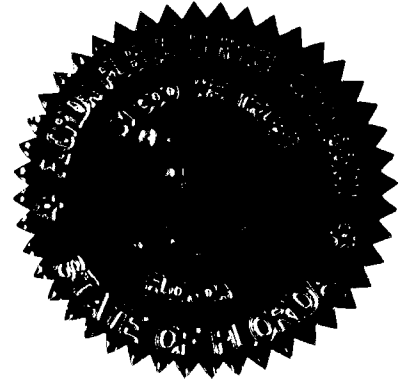


BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 030851-TP

In the Matter of

IMPLEMENTATION OF REQUIREMENTS
ARISING FROM FEDERAL COMMUNICATIONS
COMMISSION'S TRIENNIAL UNE REVIEW:
LOCAL CIRCUIT SWITCHING FOR MASS
MARKET CUSTOMERS.



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VOLUME 17

Pages 2249 through 2387

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN BRAULIO L. BAEZ
COMMISSIONER J. TERRY DEASON
COMMISSIONER LILA A. JABER
COMMISSIONER RUDOLPH "RUDY" BRADLEY
COMMISSIONER CHARLES M. DAVIDSON

DATE: Thursday, February 26, 2004

TIME: Commenced at 9:00 a.m.

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9 APPEARANCES: (As heretofore noted.)

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P R O C E E D I N G S

(Transcript follows in sequence from Volume 16.)

CHAIRMAN BAEZ: Okay, we'll go back on the record.

Mr. Beck, how do we need to proceed with you?

MR. BECK: The prehearing order allocates an hour for the OPC and the AARP, and we are going to start presenting Dr. Johnson and his testimony, and Dr. Johnson, after moving his testimony and exhibits, we are going to also make a presentation. After that, AARP plans to do an opening statement, but within the hour that is allocated to us.

CHAIRMAN BAEZ: That's fine.

MR. BECK: Dr. Johnson, have you previously been sworn?

THE WITNESS: No, I have not.

CHAIRMAN BAEZ: Doctor, will you please stand. And, by the way, since we are going to start rushing, everybody that hasn't been sworn on the previous direct case, any remaining witnesses, if you can just stand and we will swear you all in at once. Whoever is in the room.

(Witnesses sworn.)

CHAIRMAN BAEZ: All right. You're sworn.

BEN JOHNSON, Ph.D.

was called as a witness on behalf of the Citizens of the State of Florida, and having been duly sworn, testified as follows:

DIRECT EXAMINATION

1 BY MR. BECK:

2 Q Would you please state your name?

3 A Ben Johnson.

4 Q And did you cause rebuttal and surrebuttal testimony
5 to be filed in this case?

6 A Yes, I did.

7 Q And did you also distribute an errata sheet to your
8 rebuttal and surrebuttal testimony?

9 A Yes.

10 Q Do you have any other changes to either your rebuttal
11 or your surrebuttal testimony?

12 A Yes. At Page 13 of my rebuttal testimony, at Line
13 12, the ID within brackets should not be there. And the
14 material from Lines 9 through 12 should not be single spaced or
15 indented, because it is not actually a direct quote from the
16 horizontal merger guidelines. That is the only additional
17 correction I have.

18 Q Okay. With the changes contained in your errata
19 sheet and the change you just made now, if I were to ask you
20 the same questions contained in your rebuttal and surrebuttal
21 testimony today, would your answers be the same?

22 A Yes, they would.

23 MR. BECK: Mr. Chairman, I would move Dr. Johnson's
24 rebuttal and surrebuttal testimony into the record as though
25 read.

1 CHAIRMAN BAEZ: Show Dr. Johnson's rebuttal and
2 surrebuttal testimony entered into the record as though read.

3 Q And, Dr. Johnson, did you also have two exhibits
4 attached to your rebuttal testimony and a third exhibit
5 attached to your surrebuttal testimony?

6 A Yes.

7 MR. BECK: Mr. Chairman, I would ask that they be
8 marked as a composite exhibit for identification.

9 CHAIRMAN BAEZ: Show the exhibits accompanying Dr.
10 Johnson's rebuttal and surrebuttal testimony marked as
11 Composite Exhibit 103.

12 (Composite Exhibit 103 marked for identification.)

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Rebuttal Testimony of Ben Johnson, Ph.D.
On Behalf of the Citizens of the State of Florida, Docket No. 030851-TP

1 **Introduction**

2

3 **Q. Would you please state your name and address?**

4 A. Ben Johnson, 2252 Killlearn Center Boulevard, Tallahassee, Florida 32309.

5

6 **Q. Does your testimony include any Exhibits?**

7 A. Yes. Exhibit BFJ-1 is an Appendix that describes my qualifications in regulatory and utility
8 economics. I have also attached Exhibit No. BFJ-2 which contains 7 maps. These maps were
9 prepared under my supervision and are true and correct to the best of my knowledge.

10

11 **Q. What is your purpose in making your appearance at this hearing?**

12 A. I am testifying on behalf of the Citizens of the State of Florida. My testimony will rebut certain
13 portions of the testimony filed on behalf of BellSouth Telecommunications, Inc. (BellSouth),
14 Sprint-Florida/Sprint Communications LP (Sprint), and Verizon Florida Inc. (Verizon). More
15 specifically, my testimony rebuts the testimony of BellSouth witness Pleatsikas. It is also offered
16 in rebuttal of BellSouth witnesses Aron and Tipton, since they rely on Mr. Pleatsikas's market
17 definition. Similarly, my testimony rebuts the testimony of Verizon witness Fulp and Sprint
18 witness Staihr, particularly with regard to market definitions. My testimony also effectively
19 rebuts portions of the testimony of other parties, to the extent these parties have also proposed,

1 or accepted, flawed market definitions.

2 In general, my testimony is focused on the appropriate definition of the “market” for
3 purposes of evaluating the extent to which competitors would be “impaired” in attempting to
4 serve mass market customers if unbundled switching were no longer available from incumbent
5 carriers.

6

7 **Q. Would you please describe how your testimony is organized?**

8 A. Yes. I agree with the position taken by BellSouth in its direct testimony regarding the proper
9 sequencing of analyses in this proceeding:

10

11 A state commission must first define the appropriate geographic market
12 to which it will apply the impairment analysis outlined in the TRO.
13 Next, state commissions must determine the definition for the class of
14 customers that the FCC identified as “mass market.” ... Once
15 appropriate definitions of the relevant geographic areas and “mass
16 market” customers are determined, the FCC requires state
17 commissions to apply two “triggers” tests to see whether CLECs are
18 impaired with respect to serving mass market customers in each defined
19 geographic market. [Ruscilli Direct, December 4, 2003, p. 4]

20

21 Consequently, I attempt to follow this sequencing in this rebuttal testimony. In the first section,
22 I briefly sketch the background of this investigation, focusing on the Commission’s activities and
23 certain portions of the Triennial Review Order (TRO) issued by the Federal Communications
24 Commission (FCC). In the second section, I critique the BellSouth, Sprint, and Verizon

Rebuttal Testimony of Ben Johnson, Ph.D.

On Behalf of the Citizens of the State of Florida, Docket No. 030851-TP

1 proposals for defining the market, and briefly discuss some alternative approaches. In the third
2 section, I consider evidence available to the Commission which will enable it to define the mass
3 market more appropriately than has been proposed by the incumbent LECs. In the fourth
4 section, I discuss a concern that was not adequately considered by the witnesses for BellSouth,
5 Sprint and Verizon—the importance of recognizing distinctions between business and residential
6 customers—distinctions that are crucially important in reaching an appropriate result in this
7 proceeding. In the fifth section, I briefly set forth my reasons why I believe the Commission
8 should reject the proposals of the incumbent LECs.

9
10 **Q. Would you please briefly summarize the thrust of your testimony?**

11 A. Yes. In general, I stress the importance of properly defining the market, and the risk of
12 inadvertently reaching conclusions concerning impairment that are valid for mass market small
13 business customers but are not valid for residential customers. All of the geographic market
14 definitions proposed in the direct testimony of BellSouth, Verizon and Sprint—including MSAs,
15 CEAs and UNE rate zones—are too broad. Among other problems, these proposals greatly
16 increase the risk of inadvertently reaching a conclusion of non-impairment that is only valid with
17 respect to a portion of a geographic area—a conclusion that is not valid for other portions of that
18 area. The Florida Public Service Commission (Commission) should take great care to ensure
19 that the effect of its decisions in this proceeding is not to prevent competitive local exchange

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1 carriers (CLECs) from serving residential customers. In other words, CLECs should be
2 allowed to continue using switching UNEs to serve residential customers wherever it is not
3 economically feasible for them to serve these customers using their own switch.

4 Second, considering differences in revenue and profit levels, residential and small
5 business mass market customers should be studied separately, to the extent feasible. In its
6 TRO, the FCC recognized the potential importance of demand differences (e.g., average
7 revenue levels) and it asked state commissions to perform granular analyses. If the Commission
8 follows the approach advocated by BellSouth, Verizon and Sprint, and ignores important
9 differences between residential and small business mass market customers, it may develop an
10 impairment analysis that is not sufficiently granular in nature, or that reaches conclusions that are
11 only valid for small business customers (or only some small business customers)—conclusions
12 that are not valid for most residential and very small business customers.

13
14 **Background**

15
16 **Q. Could you begin your background discussion by explaining how the FCC defines the**
17 **mass market?**

18 **A.** Yes. The FCC defines the mass market as follows:
19

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1 The mass market for local services consists primarily of consumers of
2 analog “plain old telephone service” or “POTS” that purchase only a
3 limited number of POTS lines and can only economically be served via
4 analog DS0 loops. [TRO, ¶ 459]
5
6

7 **Q. What has the FCC found regarding mass market switching specifically?**

8 A. In the TRO, the FCC found that, on a national basis, “competing carriers are impaired without
9 access to unbundled local circuit switching for mass market customers.” [Id.] The FCC’s
10 conclusion was based upon its finding that “operational and economic factors associated with
11 the current hot cut process used to transfer a loop from one carrier’s switch to another’s serve
12 as barriers to competitive entry in the absence of unbundled switching...” [Id., ¶460] However,
13 the FCC recognized that “a more granular analysis may reveal that a particular market is not
14 subject to impairment in the absence of unbundled local circuit switching.” [Id., ¶461]
15 Accordingly, the FCC required state commissions to undertake a market-by-market
16 examination, to determine whether carriers requesting the mass market switching UNE would
17 be impaired if they were not given access to it in a given market. [Id., ¶ 461] The FCC
18 established two “triggers” for commissions to apply in their impairment analysis.
19

20 First, where a state determines that there are three or more carriers,
21 unaffiliated with either the incumbent LEC or each other, that are
22 serving mass market customers in a particular market using self-
23 provisioned switches, the state must find “no impairment” in that
24 market. [Id., ¶ 462]
25

Rebuttal Testimony of Ben Johnson, Ph.D.
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1 Second, a state must find no impairment when it determines that there
2 are two or more competitive wholesale suppliers of unbundled local
3 circuit switching, unaffiliated with the incumbent or each other. [Id., ¶
4 463]
5

6 If either trigger is met, commissions must find impairment in that particular market. If neither
7 trigger is met, the FCC has directed state commissions to

8
9 proceed to the second step of the analysis, in which it must evaluate
10 certain operational and economic criteria to determine whether
11 conditions in the market are actually conducive to competitive entry,
12 and whether carriers in that market actually are not impaired without
13 access to unbundled local circuit switching. [Id., ¶ 494]
14

15 According to the FCC, “operational and economic criteria” include evidence of switch
16 deployment that does not automatically satisfy the triggers, CLEC difficulties in obtaining
17 collocation space and cross-connects, costs to CLECs associated with migrating incumbent
18 local exchange carrier (ILEC) loops to their own switches, and revenue-cost comparisons
19 associated with serving mass market customers.

20 Finally, the FCC has left to the states the task of defining the market for purposes of
21 their granular impairment analyses.
22

23 **Q. Has the FCC established some parameters for defining the relevant market?**

24 **A. Yes. State commissions have considerable discretion to determine the contours of the relevant**

1 markets in their state. [TRO, ¶ 495] However, the FCC did place some limitations on that
 2 discretion. First, a state commission must use the same market definition for the “trigger”
 3 analysis and the economic impairment analysis. Second, a state commission may not define the
 4 market to encompass the entire state. Third, a commission should not define the market so
 5 narrowly “that a competitor serving that market alone would not be able to take advantage of
 6 available scale and scope economies from serving a wider market.” Finally, the Commission
 7 “should attempt to distinguish among markets where different findings of impairment are likely.”

8 [Id.]

9
 10 **Q. Has the FCC given state commissions any further guidance?**

11 A. Yes. When defining the market, the Commission must consider the following:

- 12
 13 • The locations of customers actually being served (if any) by competitors
 14 • The variation in factors affecting competitors’ ability to serve each group of customers
 15 • Competitors’ ability to target and serve specific markets economically and efficiently
 16 using currently available technologies
 17 • How competitors’ ability to use self-provisioned switches or switches provided by a
 18 third-party wholesaler to serve various groups of customers varies geographically. [Id.]

19
 20 The FCC gave some specific examples of additional factors that can be considered in defining
 21 the relevant market:

- 22
 23 • How UNE loop rates vary across the state
 24 • How retail rates vary geographically

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- 1 • How the number of high-revenue customers varies geographically
2 • How the cost of serving customers varies according to the size of the wire center and
3 the location of the wire center
4 • Variations in the capabilities of wire centers to provide adequate collocation space and
5 handle large numbers of hot cuts. [Id., ¶ 496]
6

7 Finally, the FCC recognized that state commissions may have previously established geographic
8 markets for other purposes, such as retail ratemaking, the establishment of UNE loop rate
9 zones, and the development of intrastate universal service mechanisms. [Id.] A state
10 commission's previous use of density zones or other geographic areas for purposes of setting
11 UNE loop rates is an example of a previously established geographic market definition that
12 could be relevant in the impairment analysis process. A state commission may use these existing
13 geographic areas to define the market if, after considering the above factors, it determines they
14 would be appropriate. [Id.]
15

16 **Q. How has the Commission responded to the FCC's directives?**

17 A. The Commission opened this docket on August 22, 2003 to implement the FCC's recently
18 issued TRO. The Commission also opened a docket devoted to the examination of loop and
19 transport impairment issues. This docket is devoted to the examination of mass market
20 switching issues.

21 In the immediate docket, on September 17, the Commission issued notice that it would
22 hold an issue identification conference on October 6. The Commission ordered parties to file a

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1 list of potential issues by September 29. On September 22, the Commission issued its first
2 procedural schedule which set filing dates and set guidelines for serving discovery, submitting
3 testimony, and all hearing-related activities. On October 23, 2003, a second issue identification
4 conference was held, affording parties the opportunity to put forth, discuss, and consolidate
5 issues that they felt were integral to the proceeding. An issues list was confirmed and a new
6 procedural schedule set by the Commission in its November 7 order. In response to an AT&T
7 motion to alter the procedural schedule a second time, the Commission approved the requested
8 changes on December 23. Aside from the filing of direct testimony on December 4, 2003,
9 virtually all other case activity has involved discovery.

10
11 **Market Definition**

12
13 **Q. Do you agree with the market definitions proposed by other parties in this proceeding?**

14 A. No. I disagree with the market definitions proposed most of the parties in their direct
15 testimonies. For the sake of brevity, my testimony will focus on flaws in the approaches used
16 by the major incumbent LECs (ILECs)—BellSouth, Sprint, and Verizon. To the extent other
17 parties have also used a very broad approach to defining the relevant market, my criticisms also
18 relate to their testimony.

19 Sprint proposes to declare entire metropolitan statistical areas (MSAs) as the relevant

1 geographic markets for use in this proceeding. Verizon uses MSAs to divide UNE rate zones
2 while BellSouth uses Component Economic Areas (CEAs) to divide UNE rate zones; the
3 CEAs are generally larger geographic areas than MSAs. All of these proposals are overly
4 broad.

5 BellSouth contends that “the FCC’s self-provisioning trigger is met in 13 of the 31
6 market areas.” [Tipton Direct, December 4, 2003, p. 7] Also, “applying the ‘potential
7 deployment’ methodology to the remaining 18 markets leads to the conclusion that CLECs are
8 not impaired without access to BellSouth’s unbundled switching in an additional 10 of those
9 markets.” [Aron Direct, December 4, 2003, p. 6] In sum, out of the 31 broad geographic
10 markets that BellSouth defines, it contends that CLEC impairment would not exist in 23 of them
11 if it were to no longer provide CLECs with unbundled switching. [Tipton Direct, December 4,
12 2003, p. 7] Verizon witness Fulp, in his direct testimony, presents a similar finding for the broad
13 markets that it defines:

14
15 As the data in Exhibits 2 and 3 show, Verizon meets the mass market
16 switching trigger in the Density Zone 1 and 2 areas of the Tampa-St.
17 Petersburg-Clearwater MSA. There are a total of eight unaffiliated
18 CLECs currently serving mass market customers with their own
19 switches in this area. Therefore, the Commission must find no
20 impairment in this market in Florida. [Fulp Direct, December 4, 2003,
21 p. 24]
22

23 Sprint, another large incumbent local exchange carrier (ILEC), seems to have reached

1 essentially the opposite conclusion, stating that it would not challenge the FCC's national finding
2 that impairment exists throughout all of its markets.

3

4 **Q. On what grounds do you disagree with these proposals?**

5 A. All of the geographic market definitions proposed in the direct testimony of BellSouth Verizon
6 and Sprint—including MSAs, CEAs and UNE rate zones—are too broad. Among other
7 problems, these proposals greatly increase the risk of inadvertently reaching a conclusion of
8 non-impairment that is only valid with respect to a portion of the overall geographic area—a
9 conclusion that is not valid for other portions of that broadly defined area.

10

11 **Q. How can the Commission overcome this deficiency?**

12 A. By rejecting market definitions that utilize large geographic areas and, instead, define the
13 relevant markets on the basis of a single wire center or small group of wire centers, thereby
14 ensuring that each carefully defined market has reasonably homogeneous characteristics.

15

16 **Q. Are you aware of any established guidelines that would support your proposed
17 solution?**

18 A. Yes. The Commission is venturing into largely uncharted territory, but telecommunications
19 markets have previously been defined by regulators for other purposes (e.g., reviewing requests

1 for mergers, reviewing requests for extended calling areas). Of course, until recently no one has
2 needed to define geographic markets in a manner that is specifically relevant to a finding with
3 respect to impairment.

4 In the absence of a well established body of economic literature or regulatory law
5 concerning the most appropriate method and criteria for defining the relevant market for
6 impairment purposes, it can be useful to look at what has been learned by economists and
7 regulators looking at similar issues under different circumstances. Of course, the conclusions we
8 draw from this sort of comparison must be adjusted to fit the impairment issues being analyzed
9 in this proceeding.

10 The Department of Justice (DOJ) and Federal Trade Commission's (FTC) Horizontal
11 Merger Guidelines outline two types of markets—a product market and a geographic market. I
12 believe that some of the principles set forth in these Guidelines can be appropriately applied to
13 this proceeding. In defining both geographic and product markets, the DOJ/FTC recommend
14 utilizing what they call the “smallest market” principle. They first define this principle in the
15 context of a geographic market as follows:

16
17 In defining the geographic market or markets affected by a merger, the Agency
18 will begin with the location of each merging firm (or each plant of a multiplant
19 firm) and ask what would happen if a hypothetical monopolist of the relevant
20 product at that point imposed at least a "small but significant and nontransitory"
21 increase in price, but the terms of sale at all other locations remained constant.
22 If, in response to the price increase, the reduction in sales of the product at that

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1 location would be large enough that a hypothetical monopolist producing or
2 selling the relevant product at the merging firm's location would not find it
3 profitable to impose such an increase in price, then the Agency will add the
4 location from which production is the next-best substitute for production at the
5 merging firm's location. [Id.]
6

7 It is further explained in the context of a product market.
8

9 The product market methodology ... is a conceptual process by which products
10 are added to a group of products just until a hypothetical (unregulated)
11 monopolist could profitably impose a small but significant, non-transitory
12 increase in price. [REDACTED]
13

14 In the case of both types of markets, the DOJ/FTC methodology entails starting with a small
15 area or group of products and adding area or products to that small set until a benchmark is
16 reached. This “start small and build up” principle (as I refer to it) is of crucial importance to the
17 process of defining a market in this proceeding.
18

19 **Q. Has the FCC voiced any opinions as to the applicability of the DOJ/FTC Horizontal**
20 **Merger Guidelines (HMGs) in this context?**

21 **A.** Yes. The following is an excerpt from the TRO.
22

23 Although we recognize a substantial amount of commonality between
24 the HMG’s framework for assessing ease of entry and our analysis of
25 entry barriers above, we do not adopt the standards and framework of

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1 the HMG for evaluating committed entry. First, in contrast to the HMG,
2 we are not considering whether new competitors will enter the market
3 in response to a “small but significant and nontransitory” price rise, nor
4 do we assume that incumbent LECs will be ceding a portion of the
5 market to competitors due to this price rise. [TRO, ¶ 111]
6

7 The TRO continues with a description of some other ways in which the DOJ/FTC Merger
8 Guidelines are not directly applicable here.

9
10 **Q. Does the FCC’s position in this regard preclude the Commission from utilizing the**
11 **“smallest market” principle in this proceeding?**

12 A. No. I am not suggesting that the DOJ/FTC Merger Guidelines can or should be applied on a
13 direct, step by step basis, as some parties apparently argued to the FCC. Instead, I am
14 suggesting that the Commission can rely upon these guidelines to extract some basic principles
15 that can be appropriately applied to the Commission’s impairment investigation.

16 While the FCC found that the Merger Guidelines could not be applied letter-for-letter,
17 it did recognize how well established economic reasoning, like the DOJ/FTC Guidelines, can be
18 utilized in a proceeding, such as this one, that considers slightly different issues. In fact, the FCC
19 gained some insights from these guidelines in conducting its nationwide impairment investigation.

20
21 Other doctrines and theories, such as the Horizontal Merger Guidelines
22 (HMG) used in antitrust and the economic theories developed in the
23 barriers to entry literature, were proffered by commenters as providing

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1 models for such a standard. While we discuss later why we do not
2 adopt any single one of these doctrines or theories in toto as our
3 standard, we find that the lessons learned from these legal doctrines and
4 economic theories help us develop an impairment standard, and will
5 also help us in our attempt to apply this standard in our analysis of
6 specific network elements. [Id., ¶ 73. Emphasis added]
7

8 While the FCC has not required use of the “smallest market” principle, neither has it precluded
9 use of this principle. In my opinion, the Commission would be well advised to use this approach
10 in defining the appropriate market and in studying the degree of impairment that exists in
11 providing switching services to mass market customers.
12

13 **Q. Do BellSouth, Sprint, or Verizon correctly apply the “smallest market” approach as**
14 **recommended by the DOJ/FTC in their assessment of the relevant market?**

15 A. No. In their direct testimonies, these ILECs essentially ignore the lessons that can be learned
16 from this well established body of knowledge. In fact, rather than following a “smallest market”
17 approach, the ILECs take the opposite tack, starting with extremely large areas (e.g. entire
18 UNE rate zones) then dropping down. The resulting geographic market proposals are all very
19 large. Although, Verizon and BellSouth are to be commended for at least considering the
20 geographic differences that are reflected in the existing UNE rate zones, none of these parties
21 followed a “start small and build up” approach. They started with UNE rate zones, then
22 subdivided these with respect to MSAs (Verizon) or CEAs (BellSouth) (or vice versa—the

1 process and results are essentially the same regardless of which division is applied first). The
2 final result are proposals for some very large geographic market areas.

3
4 **Q. Are there disadvantages to using large geographic areas as markets?**

5 A. Yes. If the state is divided into just a handful of broad markets, each containing widely varying
6 market conditions, the Commission will encounter grave difficulties in performing the sort of
7 granular analysis sought by the FCC in the TRO, and it runs a greater risk of inadvertently
8 reaching conclusions concerning impairment that are valid for some customers but not valid for
9 other customers.

10 MSAs, defined by the Office of Management and Budget, are no better a market
11 definition than the entire state, which the FCC has specifically prohibited. [TRO, ¶ 495] There
12 are currently 19 MSAs in Florida. These cover large portions of the state, encompassing widely
13 varying conditions. The MSAs do not cover the entire state, because many small towns and
14 rural areas are excluded (e.g., the Everglades). However, MSAs are not limited to urban areas;
15 they also include many smaller cities and towns, as well as some rural areas. In my view, the
16 MSAs are not sufficiently homogenous to offer an acceptable option. MSAs lump together
17 customers with fundamentally dissimilar choices.

18 BellSouth and Verizon proposals to use UNE rate zone as “markets” are similarly
19 flawed. Since these zones tend to separate the most urban wire centers from most rural wire

1 centers, the UNE rate zones are a step in the right direction. However, combining large
2 geographic areas like MSAs and CEAs with the UNE rates zones still results in markets that
3 are quite heterogenous. BellSouth's CEA proposal is a good example. Fort Pierce-Port St.
4 Lucie, FL is one of the 21 Florida CEAs. This is a vast geographic area. BellSouth uses its
5 boundaries to separate the UNE zones contained therein from UNE rate zones in neighboring
6 CEAs (e.g., West Palm Beach-Boca Raton, FL) because the zones can be "so geographically
7 distant that the costs of transport could impact the ability to consider these two distant locations
8 to be a single market." [Pleatsikas Direct, December 4, 2003, p. 6] While transport concerns
9 are alleviated by this proposal, it isn't sufficient to alleviate the problem of heterogeneity. CEAs
10 (like MSAs) are a mix of both urban and rural areas and, consequently, a UNE rate zone that
11 encompasses Fort Pierce may have widely differing geographic and demographic
12 characteristics than a UNE rate zone that includes Port St. Lucie, which is in the same CEA.
13 The Federal Reserve Bank of Kansas City spoke to the heterogeneity of CEAs in a recent
14 study.

15
16 The 348 CEAs form an excellent basis for analyzing the rural economy
17 because each one has a central node and a surrounding area. There are
18 a few difficulties, however. ... For instance, 59 of the Commerce
19 Department economic areas are in places such as the
20 Washington-Boston corridor that lack rural counties. In addition, there
21 are 47 economic areas in places like the Great Plains that lack an urban
22 center. For the purposes of this article, therefore, both groups have
23 been excluded. The remaining 242 economic areas are shown in Figure

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1 1. [*A New Micro View of the U.S. Rural Economy*, Mark Henry and
2 Mark Drabenstott, p. 2]
3

4 To be clear, this means that almost 70% of CEAs nationwide include a mixture of urban and
5 rural areas. While considering only a single UNE rate zone within each CEA provides a good
6 step toward granularity, it isn't necessarily sufficient. The risk remains that vast geographic
7 areas will be treated as a single market, leading to conclusions concerning impairment that are
8 valid for some customers (e.g., residents living in upscale high rise condominiums along the
9 coast, and small businesses in downtown business districts) that are not valid for other
10 customers within the same CEA/UNE rate zone (e.g., customers located in lower density,
11 lower income suburbs).

12
13 **Q. Witnesses for Sprint, Verizon and BellSouth argue that their market definitions meet
14 the TRO's market definition guidelines. Do you agree with these assessments?**

15 A. No. Recall from the previous section that the FCC directed state commissions to "attempt to
16 distinguish among markets where different findings of impairment are likely." [TRO, ¶ 495]
17 Large geographic areas like those proposed by the ILECs in this proceeding are not sufficient
18 to distinguish among markets where different findings of impairment are likely. For instance, if
19 areas with numerous enterprise customers are segregated from an area with very few enterprise
20 customers, the Commission might conclude that impairment exists in the latter area but not in

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1 the former one (because CLECs serving enterprise customers may find it is feasible to also
2 serve smaller customers). While the UNE rate zones are useful in this regard, since they were
3 established in part to account for the urban/rural distinction, these are not sufficiently granular,
4 and can still vary widely over large areas like MSAs or CEAs.

5 A better approach is one that is more closely analogous to the method set forth in the
6 DOJ/FTC Merger Guidelines. Markets should not be defined by focusing on media markets or
7 vast statistical areas, but rather by “starting small and building up.” In this way the Commission
8 can better ensure that customers facing fundamentally different competitive choices are analyzed
9 separately. For instance, this approach reduces the risk of concluding that impairment doesn’t
10 exist within an MSA, based upon conditions in areas where per-customer revenues are high,
11 then being forced to apply this same conclusion to portions of the market where per-customer
12 revenues are low, despite the fact that impairment does exist in the latter portions of the MSA.

13 Because the TRO seems to contemplate a “one size fits all” conclusion of impairment,
14 or non-impairment, for an entire market, a broad market definition increases the risk of reaching
15 a conclusion with regard to the presence or absence of impairment that is only valid for a
16 portion of the market in question.

17 The “start small and build up” approach better serves a host of other TRO guidelines
18 as well. For instance, by starting at the wire center level, one can more easily determine “the
19 locations of customers actually being served (if any) by competitors.” [TRO, ¶ 495] If one were

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1 to begin such an effort at the MSA or CEA level, it would prove far more daunting for the
2 Commission.

3 Starting with wire centers leaves the Commission with plenty of opportunity to “build
4 up” to a larger market areas, if an individual wire center is too small to meet other TRO
5 guidelines like CLEC “scale and scope economies.” Although ILEC witnesses have used this
6 guideline to argue against the use of wire centers as markets in this proceeding, I am unaware of
7 any study conducted by these ILECs which proves that CLECs cannot achieve “scale and
8 scope economies” in individual wire centers, or small groups thereof (which is my proposal in
9 this proceeding). At least from an economist’s perspective, scale and scope economies are not
10 looked at in isolation, based upon a single market, unless that market is completely unrelated to
11 any other markets. To the contrary, it is well understood that economies of scale and scope can
12 often be best achieved by serving multiple markets. Thus, for example, airlines achieve greater
13 economies of scale and scope by serving the package shipping market, the leisure travel
14 market, and the business travel market. Similarly, economies of scale and scope may be
15 enhanced by serving both the Boston-to-Miami market, the Miami-to-Atlanta market, and the
16 Atlanta-to-Boston market. While these are all separate markets, airplanes can serve multiple
17 markets, and thus while an analysis of economies of scale and scope is relevant to the
18 appropriate definition of the geographic market, the TRO requirement that such an analysis be
19 performed does not suggest that a market must be large enough to exhaust all potential

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1 economies of scale and scope without regard to the physical proximity of other markets, or the
2 potential for achieving economies of scale and scope across multiple markets.

3

4 **Q. Another argument that Sprint, Verizon and BellSouth have put forward in support of**
5 **their proposals is that they better simulate the “markets” that CLECs typically enter.**
6 **Do you agree with this position?**

7 A. No. By this logic, if it could be shown that CLECs make their initial entry decisions on the basis
8 of broad multi-state regions, it would be plausible to define the “Southeastern United States” as
9 a single market—e.g. the overall “market” in which BellSouth operates. Needless to say, the
10 entire Southeast may constitute a relevant telecommunications market for some purposes, but it
11 is not relevant for purposes of this proceeding. The reason is that *initial* CLEC entry decisions
12 are not the end of the line when it comes to CLEC entry. Entry actually entails a series of
13 decisions that a CLEC will make over time regarding operating regions, geographic markets,
14 entry method (e.g., resale, UNE-P, UNE-L), switch installation, targeted customers, and
15 others.

16

17 **Q. Can you explain why entry occurs as the result of a series of decisions?**

18 A. Yes. The correct way to view the entry process is that it is a series of decisions. From a
19 business planning standpoint, this process includes how to enter, which products to offer,

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1 whether to use their own switch or to rely on resale and the like. For example, a CLEC quite
2 realistically might decide to install a switch in Orlando, with the thought that the same switch
3 could potentially serve markets like Ocala, Jacksonville, Titusville, Melbourne, and perhaps
4 even Tampa. Similarly, the CLEC may have some specific customers in mind when it installs the
5 switch, and thus it may immediately start marketing and selling to these particular customers in
6 the Orlando area. Once it has hooked up these customers, it may look for other growth
7 opportunities. Since its switch is already in place, it might examine whether it would be
8 profitable to broaden its marketing effort and attempt to serve other customers in the Orlando
9 area, or whether it should expand to other parts of the state.

10 At some point in the expansion/entry process, the CLEC will need to analyze individual
11 wire centers, looking at the cost of collocation, the cost of connecting to customers in that wire
12 center and other factors, in order to determine if it can profitably serve that wire center with its
13 switch. This process may start with consideration of specific wire centers in the Orlando area,
14 but it may also involve analysis of wire centers in Titusville, Lakeland, Melbourne, Jacksonville,
15 etc.

16 Each step of the way, the CLEC needs to consider the fixed and variable costs of the
17 entry decision in question, taking into account the fixed cost of collocation and the other
18 investments involved in that entry option. The CLEC will not likely take the next step unless it
19 has a reasonable expectation of recovering its fixed costs over the life cycle of the investment in

1 question. The CLEC might incur collocation costs, costs for various pieces of equipment to be
2 installed in the collocation area, and additional costs required to serve both DS1 and DS0
3 customers. Thus, the decision to serve DS1 customers using the CLEC's own switch does not
4 automatically entail a decision to serve DS0 customers in that wire center. That is a different
5 entry decision—one that is separate from the decision to serve DS1 customers. Once the CLEC
6 has made the investments needed to serve DS1 customers, it may eventually find it is feasible to
7 also consider serving at least some DS0 customers. As a result, CLEC entry is not an
8 all-or-nothing decision that occurs exclusively at the MSA or CEA level. Rather, it is a
9 sequential process that evolves and changes over time, with many of the key entry decisions
10 occurring at the wire center level or at an even more granular level.

11 In order to answer the most important question in this proceeding, that being whether or
12 not Florida CLECs would be impaired if they did not have access to switching UNEs, the
13 Commission must look at the factors that influence CLEC decisions concerning the installation
14 and use of their own switching equipment—and this requires consideration of the demographic,
15 engineering and economic characteristics of individual wire centers.

16 In fact, some of the factors involved in a CLEC's decision to enter an MSA or CEA
17 may be completely irrelevant in this context, because initial entry may occur using a mixture of
18 pure resale, UNE-P and UNE-L. Similarly, the contours of existing media markets are not
19 especially important, since these contours tell us little about the cost of serving mass market

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1 customers with a CLEC switch. Even if a CLEC makes its initial entry decision on the basis of
2 broad media markets, MSAs or CEAs, this tells us nothing about whether that CLEC will use
3 its own switch, rely on pure resale, rely on UNE-P, or rely on a combination of different
4 methods. A CLEC might install a switch to serve enterprise customers, while planning to serve
5 smaller customers using pure resale or UNE-P. However, once the switch has been installed,
6 its plans may evolve, and eventually it may use the switch to serve additional types of customers
7 in some wire centers.

8 A CLEC may find it feasible to serve mass market customers in one wire center, and
9 only find it possible to serve enterprise customers in an adjacent wire center, due to differences
10 in the mix of customers (e.g., high and low revenue customers), physical constraints, or other
11 reasons. The mere fact that a CLEC switch exists in an MSA or UNE rate zone, or the mere
12 fact that a switch is used to serve some mass market customers within a particular MSA or
13 UNE rate zone, tells us very little about the ability of that CLEC, or other CLECs, to serve
14 customers in other wire centers using that switch—regardless of whether or not these wire
15 centers happen to be in the same MSA or UNE rate zone.

16 Consequently, to fully explore the issues in this proceeding, it is preferable for the
17 Commission to examine the characteristics of individual wire centers – those factors which
18 would cause or prevent a CLEC from serving that area “economically and efficiently using
19 currently available technologies.” [TRO, ¶ 495] This is a more ambitious process than simply

1 focusing on initial CLEC entry patterns, marketing efforts, or locations of existing switches, but
2 it is a necessary one if the Commission hopes to credibly define the relevant market.

3
4 **Q. Can you expand upon your concerns with respect to using large geographic areas like**
5 **MSAs for purposes of defining markets in this proceeding?**

6 A. Yes. Many MSAs cover large geographic areas that encompass a wide range of
7 heterogeneous conditions. According to the Office of Management and Budget (“OMB”):

8

9 The general concept of a Metropolitan Statistical Area or a
10 Micropolitan Statistical Area is that of an area containing a recognized
11 population nucleus and adjacent communities that have a degree of
12 integration with that nucleus. [Federal Register, Vol. 65, No. 249,
13 Wednesday, December 27, 2000]

14

15 While an MSA involves a “high degree of integration” that doesn’t imply a high degree of
16 homogeneity. To the contrary, an MSA can encompass vastly different neighborhoods, and can
17 include multiple towns, cities and counties with widely varying economic and demographic
18 conditions. Because an MSA includes “a recognized population nucleus”, it will invariably
19 include a substantial urban component. Since most urban areas include a suburban fringe of
20 bedroom communities, a typical MSA includes a mixture of both urban and suburban markets.
21 Furthermore, in a state like Florida, which includes many rural areas, an MSA may include
22 miles of lightly populated rural areas beyond the suburbs.

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1 **Q. Has the OMB recognized the heterogeneity of MSAs?**

2 A. Yes. The OMB explains:

3

4 The Metropolitan and Micropolitan Statistical Area Standards do not equate to
5 an urban-rural classification; all counties included in Metropolitan and
6 Micropolitan Areas and many other counties contain both urban and rural
7 territory and populations. [Id.]
8

9 Collectively, the OMB refers to Metropolitan and Micropolitan Statistical Areas as Core Based
10 Statistical Areas (CBSAs). CBSAs are used to “provide nationally consistent definitions for
11 collecting, tabulating, and publishing federal statistics for a set of geographic areas”. [OMB
12 Press Release 2003-18, June 6, 2003]. The OMB cautions against using CBSAs for anything
13 other than their intended purpose:
14

15 In periodically reviewing and revising the definitions of these areas, OMB does
16 not take into account or attempt to anticipate any non-statistical uses that may
17 be made of the definitions, nor will OMB modify the definitions to meet the
18 requirements of any non-statistical program. Thus, OMB cautions that agencies
19 should not use the Metropolitan Statistical Area and Micropolitan Statistical
20 Area definitions to develop and implement Federal, State, and local
21 non-statistical programs and policies without full consideration of the effects of
22 using these definitions for such purposes. [Id.]
23

24 The OMB further states:
25

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1 Program designs that treat all parts of a CBSA as if they were as urban as the
2 densely settled core ignore the rural conditions that may exist in some parts of
3 the area. [Federal Register, Vol. 65, No. 249, Wednesday, December 27,
4 2000]
5

6 **Q. What is the danger of ignoring the distinction between the rural and urban components**
7 **of an MSA?**

8 A. There can be extreme differences in operating and engineering characteristics between wire
9 centers within the downtown urban core and wire centers toward the far edges of the MSA. In
10 turn, these differences translate into substantial differences in the cost of using a CLEC switch
11 to serve mass market customers in different wire centers within a single MSA. For example,
12 different UNE loop rates may apply to urban and rural wire centers within an MSA. For this
13 and other reasons there may be substantial differences in the effective cost per line of serving
14 customers using a CLEC switch (e.g., due to differences in available economies of scale with
15 respect to inter-office transport facilities and collocation facilities).

16 Similarly, the mix of high revenue customers and low revenue customers may differ
17 throughout an MSA. Hence, CLECs may confront entirely different conditions in considering
18 the potential for using their own switch to serve mass market customers in different parts of an
19 MSA. By overlaying UNE rate zones with MSAs or CEAs, Verizon and Bellsouth have
20 mitigated some of this heterogeneity, but they have not eliminated the problem. Instead, it would
21 be preferable to define the relevant markets on the basis of individual wire centers, or small

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1 clusters of wire centers having homogeneous characteristics.

2

3 **Q. Have you prepared any evidence which validates this concern?**

4 A. Yes. I have prepared some maps of the State of Florida, the Tampa-St. Petersburg-
5 Clearwater MSA, and the combined Miami and Fort Lauderdale Component Economic Areas
6 (CEA). The latter maps coincide with an example of a BellSouth recommended geographic
7 market area in South Florida.

8

9 **Q. Can you describe these maps in more detail?**

10 A. Yes. Exhibit No. BFJ-2, page 1 shows the 19 Florida MSAs. This map reflects the current
11 MSA boundaries as published by the U.S. Census Bureau.

12 For reference and orientation, Exhibit BFJ-2, page 2 shows these 19 MSAs in context,
13 with the city limits and U.S. highways and interstates. One can easily see that all of the major
14 population centers in the state are centered within an MSA, but the MSAs are not limited to
15 urban areas. The MSAs are large geographic areas that encompass numerous small towns and
16 rural areas, as well as suburban areas.

17

18 **Q. Now let's turn to your map of the Tampa MSA. What do you show on this map?**

19 A. Exhibit No. BFJ-2, page 3 shows the location of the ILEC switches (dots), and the

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1 approximate location of ILEC wire center boundaries within the Tampa MSA. There are 55
2 wire centers in the Tampa MSA, including 49 served by Verizon, 3 by Bell South, and 3 by
3 Sprint. This map visually distinguishes wire centers on the basis of approximate line density.
4 As this map demonstrates, the MSA is quite heterogeneous. Comparing the CLEC switch data
5 presented in Verizon Witness Fulp's Exhibit No. ODF-1 with the data in this map, it is clear
6 that the CLECs have only penetrated portions of the MSA—primarily some of the denser, more
7 urbanized areas.

8

9 **Q. Now let's turn to your maps of the combined Miami Ft. Lauderdale CEAs. What do**
10 **you show on these maps?**

11 A. Exhibit No. BFJ-2, page 4 is very similar to the map just discussed. This map shows the
12 location of the ILEC switches (dots), and the ILEC wire center boundaries within the 3
13 counties comprising these CEAs (Dade, Broward, and Monroe). Of the 57 wire centers in this
14 3 county area, 56 are served by Bell South, and 1 by Sprint. This map distinguishes wire
15 centers on the basis of density (access lines per square mile). Exhibit No. BFJ-2, page 5
16 shows the same wire centers distinguished on the basis of UNE rate zone.

17 The actual area served in the western portions of Dade and Broward county is less than
18 the areas shown, because much of the western portion of these counties are uninhabited parts
19 of the Everglades. In the maps to follow we have estimated the actual area being served by

1 the ILEC switches using a Bell South Exhibit (Pleatsikas' Exhibit No. CJP-2) and publically
2 available wire center area data from the FCC's Hybrid Cost Proxy Model (HCPM).

3

4 **Q. Have you been able to analyze CLEC activity in detail?**

5 A. No. According to Bell South, "CLECs have deployed more than 100 switches in Florida, at
6 least 30 of which are serving over 100,000 'mass market' customers." [Tipton Direct (revised),
7 December 30, 2003, p. 3].

8 A close inspection of Bell South witness Tipton Exhibit No. PAT-1 (which purports to
9 list the CLEC switches deployed in Florida) reveals that there are many entries with the exact
10 same CLLI (Common Language Location Identifier) code. While it is possible to have multiple
11 switches at the same location, they are normally assigned different CLLI codes to distinguish
12 the different types of equipment.

13 The source of the data included in Exhibit No. PAT-1 is the Local Exchange Routing
14 Guide (LERG) database, but it is unclear how the database was queried, or why there are so
15 many seemingly duplicate entries with the same CLLI codes. Moreover, the CLEC switch data
16 from the Bell South Exhibit apparently includes all CLEC switches regardless of their type (e.g.,
17 voice, data) or the customers they are serving (e.g., mass market, enterprise). Ideally Bell
18 South would have identified only CLEC voice grade switches that it has reason to believe are
19 serving significant numbers of mass market customers. At the time this testimony was written I

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1 did not have access to detailed data concerning CLEC switches. Without access to the
2 underlying CLEC switch data, I was not able to analyze this issue in detail, and thus I am unable
3 to confirm or refute the BellSouth allegations with respect to CLEC switches.

4 However, Exhibit No. PAT-1 included street address locations of CLEC switches
5 deployed in Florida. Using this Exhibit we were able to digitize 28 of the 31 non-duplicate
6 CLEC switch addresses in Dade and Broward counties. These data have been superimposed
7 upon the ILEC switches and wire centers in my Exhibit No. BFJ-2, pages 6 and 7.

8

9 **Q. Can you please describe these next two maps?**

10 A. Yes. Exhibit No. BFJ-2, page 6 shows the 17 CLEC switches in Bell South's UNE Rate Zone
11 1. Exhibit No. BFJ-2, page 7 shows the 11 CLEC switches in Bell South's UNE Rate Zone 2.
12 These maps do not show where the CLECs are serving customers, nor do these switches
13 necessarily serve any mass market customers. Nevertheless, they do provide some useful
14 information concerning where the CLEC switches are located. It is apparent that the CLECs
15 have generally chosen to locate their switches in the more urbanized portions of the CEAs. It
16 appears likely that many of these switch locations were chosen for their proximity to enterprise
17 customers.

18

19

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1 **Q. Do you agree with the ILEC proposals for defining geographic markets?**

2 A. No. Defining broad geographic markets may appear to simplify the issues, but it will actually
3 make the Commission's decision making process much more difficult, and it could lead to
4 results that are inappropriate, illogical, or misleading. If the Commission uses a top-down
5 approach (e.g. defining the market to include entire MSAs or rate zones within MSAs), it
6 increases the risk that it will not be able to resolve important differences in the degree of
7 impairment within that large area.

8 For instance, the data may reveal that CLEC entry has been disproportionately
9 concentrated in certain portions of the MSA or CEA (e.g. where enterprise customers are
10 located). There is no basis for assuming that entry patterns that have occurred in a downtown
11 area or business district can easily be replicated in a suburban or rural area. This is particularly
12 true if differences between business and residential customers are ignored. Market conditions in
13 the downtown area (e.g., number of enterprise customers) may be atypical, and thus entry may
14 not easily be replicated in the residential market, or in other parts of the overall MSA.

15 The pattern of entry revealed in the data may suggest that some CLECs have entered
16 the market and have installed switching facilities primarily to serve enterprise customers. Some
17 parties may argue from this evidence that the entire large geographic market should be assumed
18 to be competitive, and the presence or absence of enterprise customers is irrelevant. Other
19 parties may argue on the same basis that the entire large geographic market should be assumed

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1 to be impaired, since none of the CLECs are serving mass market customers throughout the
2 entire large geographic area. Neither argument would be completely persuasive, or responsive
3 to the FCC's request for a granular analysis.

4

5 **Mass Market/Enterprise Market Breakpoint**

6

7 **Q. Do you agree with the "mass market customer" definitions proposed by other parties**
8 **in this proceeding?**

9 A. Not necessarily; while they correctly state some aspects of this issue, they do not adequately
10 consider all of the important factors that the Commission should consider. For instance, Sprint
11 defines a mass market customer as one who purchases less than 13 DS0 loops.

12

13 Exhibit KWD-1, attached to my testimony, calculates the average
14 economic crossover a competitive local exchange carrier (CLEC)
15 would experience in serving the [*sic*] an analog customer in the
16 territories of the three largest incumbent local exchange carriers (ILEC)
17 within the state of Florida based on the number of analog voice lines
18 used by the customer. ... The model results indicate that up to 12 DS-
19 0s at a customer's location purchasing individual loops is more cost
20 effective than purchasing single DS-1. [Dickerson Direct, December 4,
21 2003]

22

23 Similarly, Mr. Gillan, a witness for Florida Competitive Carriers Association (FCCA) in this
24 proceeding, advises the Commission to not set the "cut-over" (or dividing line) between mass

1 market and enterprise customers too low.

2

3 By failing to consider these factors, the DS0/DS1 cut-over required by
4 the FCC will strand some customers from competitive choice because
5 they will not *really* be in a position to take advantage of a DS-1
6 connection, they will only be *presumed* able to do so. Consequently,
7 the Commission should be especially careful that it not adopt a cut-over
8 that is unreasonably low, because even a “theoretically correct” cut-
9 over is likely to adversely effect some customers. [Gillan Direct,
10 December 4, 2003, p. 27]

11

12 While I understand the reasoning that underlies this portion of their testimony, I am
13 concerned that they are taking too narrow a view of the issue, and the approach they are
14 advocating could exacerbate the problem of accurately distinguishing between markets (or sub-
15 markets) that CLECs are able to serve using their own switching equipment, and markets (or
16 sub-markets) where impairment exists. Setting a high “cut-over” may exacerbate the already
17 considerable risk that the impact of this proceeding will be to reduce competitive options for
18 residential and small business customers.

19

20 **Q. Would you please describe how the “cut-over” relates to the process of defining a**
21 **mass market customer?**

22 A. Yes. In the TRO, the FCC found that, on a nationwide basis, CLECs serving “mass market”
23 customers are presumed to be impaired, unless individual state commissions determine

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1 otherwise. The FCC concluded that impairment differed for large and small customers, leading
2 it to establish a distinction between what it referred to as the “enterprise” and “mass” markets.
3 The FCC apparently saw the tradeoff between DS1 and DS0 service as the primary
4 consideration in distinguishing these two market categories:

5
6 The mass market for local services consists primarily of consumers of
7 analog “plain old telephone service” or “POTS” that purchase only a
8 limited number of POTS lines and can only economically be served via
9 analog DS0 loops. [Id., ¶ 459]
10

11 On its face, this language seems to suggest the “cut-over” between the “enterprise” and “mass”
12 markets would reflect the technical and economic factors that determine when it is feasible to
13 serve customers using DS1 loops. An important factor that influences this “cut-over” is the
14 number of lines used by the customer.
15

16 Mass market customers are analog voice customers that purchase only
17 a limited number of POTS lines, and can only be economically served
18 via DS0 loops. ... At some point, customers taking a sufficient number
19 of multiple DS0 loops could be served in a manner similar to that
20 described above for enterprise customers—that is voice services
21 provided over one or several DS1s. [Id., ¶ 497]
22

23 In its TRO, the FCC adopted a tentative cut-over of four lines, while delegating to the states
24 responsibility for making a final determination on the appropriate cut-over:

1 This cross over point may be the point where it makes economic sense
2 for a multi-line customer to be served via a DS1 loop. We expect that
3 in those areas where the switching carve-out was applicable (i.e.,
4 density zone 1 of the top 50 MSAs), the appropriate cutoff will be four
5 lines absent significant evidence to the contrary. [Id.]
6

7 **Q. Given this context, is there other support for the higher cut-overs that Sprint proposes**
8 **and FCCA wants?**

9 A. Yes. While the FCC adopted a cut-over of four lines, some of the FCC’s language seems to
10 suggest the possibility of a much higher cut-over. In the quote I cited above, the FCC states
11 that “at some point” mass market customers could require a “sufficient” number of DS0 loops
12 such that they take on the characteristics of an enterprise customer. Phrased in that manner, it
13 sounds as if the cross over point isn’t necessarily at four lines. A “sufficient” number could
14 easily be more than four lines. In a supranote to that same portion of the TRO, the FCC states
15 the following.
16

17 ... Setting the cut-off at an unconditional four lines would result in more
18 customers being treated as enterprise customers subject to our finding
19 of no impairment. If, on the other hand, a state finds based on record
20 evidence that a cut-off of more than four lines is appropriate, more
21 multi-line customers will be treated as mass market customers. ... In
22 such markets, then, it is more likely that there will be a finding of no
23 impairment for the entire market, leading to significantly less unbundled
24 switching than was available under the previous four-line carve-out.
25 [Id., supranote 1546]
26

1 **Q. Are there some potential risks if the Commission concludes that the appropriate cut-**
2 **over is higher than four lines?**

3 A. Yes. This will increase the number of customers that are classified as falling within the “mass
4 market” and reduce the number of customers in the “enterprise” category. With a higher cut-
5 over, the potential impact on residential consumers increases, because it increases the chances
6 that the Commission will conclude that “no impairment” exists for CLECs serving at least some
7 of the customers in the mass market (so defined). For instance, there may be instances in which
8 CLECs are customers with 7 or more lines, but they are serving very few (if any) customers
9 with fewer than four lines. With a cut-over of 12 lines, rather than four lines, the Commission
10 may conclude that impairment doesn’t exist for the “mass market,” based on the observed
11 competitive activity involving customers with 7 or more lines. However, the characteristics of
12 these small business customers may be completely different than the characteristics of smaller
13 business and residential customers.

14 As the FCC stated above, a higher cut-over tends to classify more customers as being
15 in the “mass market.” If the cut-over is increased from four lines to twelve lines, the mass
16 market category will include not only residential and very small business customers, but it will
17 also include somewhat larger small business customers—those that purchase as many as eleven
18 lines. As the FCC suggested, under that scenario, “it is more likely that there will be a finding of
19 no impairment for the entire market,” and there will be “significantly less unbundled switching

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1 than was available under the previous four-line carve-out.” [TRO, supranote 1546] Unless
2 some other steps are taken to distinguish between small business and residential customers, this
3 could result in significantly less competition for residential customers because CLECs will no
4 longer be able to use UNE switching to serve residential customers, nor will they necessarily be
5 able to use their own switching facilities to do so.

6
7 **Demand-Based Market Distinctions**

8
9 **Q. Do you have any additional concerns with the direct testimonies of other parties to**
10 **this proceeding?**

11 A. Yes, and it is a significant one. I am very concerned that no other party in this proceeding has
12 recognized the importance of studying residential and small business customers separately.
13 Once a geography-based market has been defined, and once mass market customers have
14 been defined according to an appropriate cut-over, the Commission should consider another
15 layer of granularity before reaching its final decisions in this proceeding—by considering
16 important demand factors that tend to distinguish which customers can economically be served
17 using a CLEC’s own switch.

18 In its TRO, the FCC recognized the potential importance of demand differences (e.g.,
19 average revenue levels) when it asked state commissions to perform granular analyses. If the

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1 Commission follows the approach advocated by other parties, and conducts an impairment
2 analysis that is not sufficiently granular in nature, it risks reaching conclusions that are only valid
3 for some portions of the mass market (e.g. higher revenue customers)—conclusions that are not
4 valid for all portions of that market (e.g. lower revenue customers).

5 None of the ILEC witnesses adequately consider this type of granularity. While
6 geography is important, it isn't the only factor that needs to be considered. Most obviously,
7 residential and small business mass market customers have different demand characteristics,
8 which may impact the degree to which impairment exists. Hence, data for these customers
9 should be obtained and analyzed separately. Residential and small business mass market
10 customers tend to purchase different products (or pay different rates for similar products), and
11 this may influence the degree to which impairment exists. From an economic perspective, it is
12 appropriate to recognize that residential and business customers purchase services in distinct
13 product markets (or sub-markets). Residential and business mass market switched services
14 can appropriately be placed in separate markets, since the underlying market conditions,
15 including typical rate structures, rate levels and gross profit margins, are so different.

16

17

18

19

1 **Q. Earlier, you indicated that the definition of the market that is relevant in a particular**
2 **context may differ from the appropriate definition in another context. Could it be**
3 **appropriate to group customers with fundamentally different demand characteristics**
4 **into two separate markets or sub-markets?**

5 A. Yes. In fact, it is common to distinguish between residential and business customers, or to
6 speak of the “residential market” separately from the “business market,” just as it is common to
7 distinguish between a “retail market” and a “wholesale market” even where essentially the same
8 products (e.g., automobiles) are being sold in each market.

9 In the current proceeding, a key issue is whether there are differences between the
10 residential and business markets that might cause CLECs to face differing levels of impairment
11 in considering the potential for using their own switching equipment to serve residential and
12 business customers. While the extent and importance of these differences cannot be known at
13 this early stage of the proceeding, it is readily apparent that the potential exists for various
14 differences in these markets to prove significant, leading to different conclusions concerning the
15 degree of impairment that exists depending upon whether the Commission is focusing on
16 residential customers or business customers. If residential and business customers are lumped
17 into a single market, evidence may be overlooked, or not obtained, which would cause the
18 Commission to reach very different conclusions concerning the degree of impairment,
19 depending upon whether it is focusing on residential or business market data. Just as it would be

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1 inadvisable to lump Cleveland and Miami together when analyzing winter weather conditions, it
2 would not be appropriate to lump residential and business customers together when analyzing
3 impairment conditions in this proceeding.

4 From a CLEC's perspective, the opportunities and pitfalls in trying to profitably attract
5 and serve residential customers may be entirely different than the corresponding opportunities
6 and pitfalls involved in serving mass market business customers. The revenues generated by a
7 typical customer are greatly different in the residential and business markets. The great majority
8 of residential customers have only a single phone line, the remainder generally have just two. It
9 is much more common for business customers to have three or more lines. As well, revenues
10 tend to vary widely due to differences in rate levels, rate structures, and service quantities (e.g.,
11 number of toll minutes). Accordingly, the average revenue received from a typical small
12 business customer is likely to be many times greater than the average revenue received from a
13 typical residential customer. (The discrepancy is even greater when considering low income
14 residential customers and others who don't purchase optional services like Call Waiting and
15 Caller ID). Because of these fundamental differences, a CLEC may conclude that gross profit
16 margins are larger in the business market and, therefore, conclude that it cannot afford the high
17 collocation costs and other burdens of connecting residential customers to its own switch.

18 While per-customer revenue differences are probably the most important factor to
19 consider, there may be other factors that influence the ability of CLECs to profitably service

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1 residential and small business customers using their own switch. For example, a CLEC may
2 conclude that business customers are more responsive to innovation and quality improvements.
3 As a result, it may decide the added costs of connecting business customers to its own switch
4 can be justified by the ability to market its offerings as providing higher quality or more
5 technically advanced features than what BellSouth offers. In the residential market, in contrast,
6 the CLEC may conclude this type of marketing pitch will not be persuasive, and thus it cannot
7 profitably serve residential customers using its own switching equipment.

8 Given these many differences, a CLEC may find it is feasible to serve business
9 customers using its own switch, while simultaneously finding it cannot profitably serve residential
10 customers using that same piece of equipment. Stated differently, differences in the underlying
11 market characteristics may justify placing residential and business customers in two separate
12 markets or sub-markets.

13
14 **Q. While the distinction between residential and business mass market switched services**
15 **may be a valid one from an economic perspective, there may be some dispute about**
16 **whether this is a legally viable distinction in this context. Can you provide any insight**
17 **into this issue from your perspective as an economist?**

18 A. Yes. It appears to me that the FCC has obligated state commissions to more precisely define
19 the mass market within their state, but it did not clearly state what parameters can, or cannot,

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1 be considered in defining the relevant market. The language in the TRO is focused primarily on
2 geography, but the FCC has not explicitly prohibited consideration of other factors. In fact, at
3 various points in the TRO the FCC mentions relevant customer characteristics like the average
4 number of customer lines and average per line or per customer revenues.

5 Because this proceeding is essentially one of “first impression,” which is being held
6 simultaneously with similar proceedings throughout the country, the ambiguities in the TRO have
7 not yet been clarified (e.g., by appellate court decisions). However, it seems clear that the FCC
8 is requiring state commissions to make several interrelated decisions, and these decisions are
9 supposed to be accomplished on a granular basis. The first of these decisions concerns the
10 appropriate definition of a market. The primary thrust of this definition is clearly geographic,
11 but the TRO does not appear to explicitly prohibit state commissions from adopting market
12 definitions that consider both geography and product or demand characteristics (e.g., stratified
13 by average revenue per customer, or stratified between residential and business customers) in
14 this process. State commissions must then decide on an appropriate way to distinguish the
15 mass market from the enterprise market. This process does not entail geographic
16 characteristics, but rather, demographic ones.

17 Furthermore, the FCC seems to recognize, at least obliquely, that markets can also be
18 stratified or defined with reference to customer characteristics. Consider for instance, this
19 passage:

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1 As discussed above, the record does not contain sufficient detail
2 concerning which geographic and **customer** markets may in fact allow
3 economic entry. In addition, impairments that exist today in certain
4 markets may be remedied in the future due to the implementation of a
5 batch cut process, as discussed above. Because our standard and the
6 guidance from the *USTA* decision require that the determination of
7 impairment be made on a granular basis, and because the record
8 provides insufficient evidence concerning the characteristics of
9 particular markets, we find it appropriate to ask the states to assess
10 impairment in the mass market on a market-by-market basis. [TRO pp.
11 493, emphasis added]
12

13 **Q. Has the FCC recognized that customer characteristics may impact the presence or**
14 **absence of impairment?**

15 A. Yes. For instance, the FCC recognized that customer-specific factors can influence whether or
16 not impairment exists:
17

18 Mass market customers consist of residential customers and very small
19 business customers. Mass market customers typically purchase
20 ordinary switched voice service (Plain Old Telephone Service or
21 POTS) and a few vertical features. Some customers also purchase
22 additional lines and/or high speed data services. Although the cost of
23 serving each customer is low relative to the other customer classes, the
24 low levels of revenue that customers tend to generate create tight profit
25 margins in serving them. The tight profit margins, and the price
26 sensitivity of these customers, force service providers to keep per
27 customer costs at a minimum. Profits in serving these customers are
28 very sensitive to administrative, marketing, advertising, and customer
29 care costs. These customers usually resist signing term contracts. [Id., ¶
30 127]
31

1 In this passage, the FCC recognizes that profit margins in serving smaller customers are
2 tighter than those available when serving larger customers, and this clearly has important
3 implications in determining whether or not impairment exists. While the FCC didn't focus
4 specifically on differences in average revenues per line or per customer, the overall thrust of this
5 reasoning is consistent with an approach which draws such a distinction. As the revenue per
6 customer declines, it becomes less and less feasible to profitably serve a customer using a
7 CLECs own switch, because insufficient profit margins exist to overcome the fixed (per-
8 customer) costs of providing service using the CLECs own facilities.

9 For this reason, one would anticipate that relatively few CLECs will serve residential
10 customers using their own switches. Rather, CLECs that use their own switches primarily focus
11 on serving larger customers—those generating much higher revenues per customer. As the FCC
12 has recognized:

13
14 ...although serving these customers is more costly than mass market
15 customers, the facts that enterprise customers generate higher revenues,
16 and are more sensitive to the quality of service, generally allow for
17 higher profit margins.” [Id., ¶ 128]
18

19 Unless these differences in customer characteristics and gross profit margins are
20 adequately considered in defining the market, and there is a great risk of inadvertently reaching
21 conclusions concerning impairment that are only valid for mass market small business

1 customers—conclusions that are not valid for residential customers, particularly those with low
2 incomes or living on a fixed income.

3

4 **Q. Do you have any recommendations with regard to the distinction between residential**
5 **and business (or low and high revenue) customers?**

6 A. Yes. To the extent it is legally permissible, it could be helpful to stratify each geographic market
7 in order to analyze business and residential customer data separately. If this is done, the analysis
8 of whether or not impairment exists could be performed separately with respect to business and
9 residential customers. Thus, for example, even if there is reason to believe a “trigger” has been
10 pulled (due to the presence of multiple CLECs) for the small business market or segment, this
11 wouldn’t automatically force the Commission to conclude that the “trigger” has also been pulled
12 for the residential market or segment.

13 Another option would be to distinguish between the “enterprise” and “mass” market on
14 the basis of revenue per customer, or on the basis of gross profit margin per customer
15 (revenues minus direct costs), rather than purely on the basis of the number of DS0 lines. This
16 could lead to more accurate and homogenous market classifications than a system based purely
17 on the number of lines used by each customer (e.g. four DS0 or 12 DS0 lines).

18 For instance, rather than placing all customers with four or more lines in the “enterprise”
19 market, the Commission might place all customers generating revenue of less than \$100 per

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1 month in the “mass” market. With a classification system of this type, the Commission may find
2 it has greater flexibility in determining the most appropriate “break point” and thus it will have an
3 enhanced ability to ensure that the defined markets are sufficiently homogenous.

4 Revenue-based market definitions would better enable the Commission to take into
5 account differences in underlying market conditions, including typical rate structures, rate levels,
6 and gross profit margins associated with different types of customers. This is consistent with
7 language in the TRO that requires state commissions to take into account “the variation in
8 factors affecting competitors’ ability to serve each group of customers, and competitors’ ability
9 to target and serve specific markets economically and efficiently using currently available
10 technologies.” [Id., ¶ 495]

11 Regardless of what specific approach the Commission ultimately adopts, it should take
12 great care to ensure that its decisions do not prevent competitive local exchange carriers
13 (CLECs) from serving residential customers. CLECs should be allowed to continue using
14 switching UNEs to serve residential customers if it isn’t economically feasible for them to serve
15 these customers using their own switch.

1 **Recommendations**

2

3 **Q. Would you please briefly summarize your recommendations for Commission action at**
4 **this stage in the proceeding?**

5 A. Yes. Due to the wide variations that exist within MSAs, and to a lesser extent UNE rate zones,
6 it would be preferable to follow the type of “start small and build up” approach used by the
7 DOJ and FTC. For instance, the Commission could carry forward with its analysis based upon
8 the tentative conclusion that the area served by each wire center is unique, and therefore
9 evidence needs to be gathered and analyzed for each wire center separately. However, as the
10 evidence accumulates and is analyzed by the parties, they should look to see if certain groups of
11 wire centers are relatively homogenous in their characteristics, and thus should appropriately be
12 grouped together. For instance, wire centers could be grouped according to the likelihood that
13 a CLEC would enter. Since CLECs would typically (as a part of the series of decisions that
14 they make when entering a market) pursue high margin customers during the initial entry period,
15 one could group wire centers in a metropolitan area both geographically and by the number of
16 DS1 and DS3 customers present there.

17 In this regard, it is logical to assume that facilities-based CLECs will initially be drawn
18 to areas where enterprise customers are abundant, where there are large numbers of customers
19 generating substantial revenues, and where per-line costs are low. Recall that the FCC required

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1 state commissions, in developing a market definition, to consider

2

3 locations of customers actually being served (if any) by competitors, the
4 variation in factors affecting competitors' ability to serve each group of
5 customers, and competitors' ability to target and serve specific markets
6 economically and efficiently using currently available technologies.

7 [TRO, ¶ 495]
8

9 These considerations cannot be adequately considered without considering variable geographic
10 and economic factors within an MSA, CEA or UNE rate zone. By defining the relevant market
11 as a small cluster of wire centers (e.g., ones having homogeneous characteristics) the
12 Commission will be embarking on an analytical process that is consistent with the guidelines set
13 forth by the FCC in the TRO. State commissions are required to consider actual customer
14 locations, the CLECs' ability to target specific markets, and geographic differences in CLEC
15 entry patterns. For example, state commissions are supposed to consider variations in the
16 number of high revenue customers and variations in existing UNE and retail rate levels. Each of
17 these factors can only be accurately analyzed at the wire center level. Accordingly, the
18 Commission should not rely solely on CEAs, MSAs and UNE rate zones in defining the
19 relevant market for the purpose of analyzing impairment.

20

21 **Q. Does this complete your direct testimony that was prefiled on January 7, 2004?**

22 **A.** Yes, it does.

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1 **Introduction**

2

3 **Q. Would you please state your name and address?**

4 A. Ben Johnson, 2252 Killearn Center Boulevard, Tallahassee, Florida 32309.

5

6 **Q. Are you the same Ben Johnson who earlier filed rebuttal testimony in this proceeding?**

7 A. Yes, I am.

8

9 **Q. Does your surrebuttal testimony include any Exhibits?**

10 A. Yes. Exhibit BFJ-3 summarizes the positions taken by the parties filing testimony in this
11 proceeding on the issue of the appropriate definition of a market.

12

13 **Q. What is your purpose in filing this surrebuttal testimony?**

14 A. In this filing I will respond to the rebuttal testimonies of BellSouth Telecommunication: nc.
15 witness Pleatsikas, Florida Competitive Carriers Association (FCCA) witness Gillan, MCI
16 Worldcom Communications, Inc. (MCI) witness Bryant, Sprint-Florida/Sprint Communications
17 LP (Sprint) witness Staihr, and Verizon Florida Inc. witnesses Fulp and Taylor. These parties
18 ("listed parties") addressed issues I discussed in my rebuttal testimony. Due to time and
19 resource constraints, I have not attempted to address each and every point included in their
20 testimonies, particularly since many of their arguments were already dealt with in my rebuttal
21 testimony. Instead, I will take this opportunity to clarify my recommendations, and to emphasize
22 the risks associated with the alternatives advocated by the listed parties. The fact that I do not

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1 discuss other portions of their rebuttal testimonies should not be construed as agreement with
2 such testimony.

3

4 **Q. How is your testimony organized?**

5 A. I first very briefly restate the major points in my rebuttal testimony, and discuss whether, and to
6 what extent, these points were addressed in the rebuttal testimonies of the listed parties. I then
7 respond, in turn, to the listed parties' rebuttal testimonies concerning three main issues: (1)
8 market definition; (2) the breakpoint between the mass market and the enterprise market; and
9 (3) the distinction between residence and business product markets.

10

11 **Major Points in Rebuttal Testimony**

12

13 **Q. To place the listed parties' rebuttal testimonies into context, can you please briefly**
14 **describe the major points included in the rebuttal testimony you filed on January 7,**
15 **2004?**

16 A. Yes. My rebuttal testimony centered on three major themes. First, I stressed the importance of
17 properly defining the market, and the risk of inadvertently reaching conclusions concerning
18 impairment that are valid for some mass market customers but are not valid for others.
19 Geographic market definitions like MSAs, CEAs and UNE rate zones are too broad. Among
20 other problems, these proposals greatly increase the risk of inadvertently reaching a conclusion
21 of non-impairment that is only valid with respect to a portion of a geographic area—a conclusion
22 that is not valid for other portions of that area.

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1 Second, the Commission is obligated to set a breakpoint to distinguish between
2 customers in the mass market and those in the enterprise market. I alerted the Commission to
3 the lack of guidance that the FCC provided in its TRO regarding this issue. In response to the
4 testimony of Sprint witness Dickerson, suggesting a breakpoint of 12 lines, I cautioned the
5 Commission that a higher cut-over tends to classify more customers as being in the “mass
6 market.” As noted by the FCC, with a higher breakpoint, “it is more likely that there will be a
7 finding of no impairment for the entire market,” and there will be “significantly less unbundled
8 switching than was available under [a] four-line carve-out.” [TRO, supranote 1546]

9 Third, considering differences in revenue and profit levels, residential and small business
10 mass market customers should be studied separately, to the extent feasible. In its TRO, the
11 FCC recognized the potential importance of demand differences (e.g., average revenue levels)
12 and it asked state commissions to perform granular analyses. If these important differences
13 between residential and small business mass market customers are completely ignored, the
14 impairment analysis may not be sufficiently granular, or it may reach conclusions that are only
15 valid for some small business customers—conclusions that are not valid for most residential and
16 smaller business customers.

17
18 **Q. Did any of the listed parties address these issues in their rebuttal testimony?**

19 **A.** Yes, many of these issues were discussed by the listed parties in their rebuttal testimony.
20
21
22

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1 **Market Definition**

2

3 **Q. Which of the listed parties, in their rebuttal testimonies, took a stance contrary to your**
4 **own regarding the issue of market definition?**

5 A. BellSouth witness Pleatsikas, Sprint witness Staihr, Verizon witness Taylor, and FCCA witness
6 Gillan testified in favor of broad geographic market definitions, and against narrow market
7 definitions, although they were not in agreement as to the appropriate broad definition.

8

9 [Dr. Bryant's wire center] aggregation is not reasonable because it
10 does not sufficiently consider substitutability in supply. That is, it fails to
11 consider whether efficient competitors using self-provisioned (or
12 third-party) switching to provide service in certain wire centers could,
13 within a sufficiently short period of time, render supracompetitive
14 pricing by the incumbent in another, proximate wire center unprofitable
15 (i.e., because a sufficient number of the incumbent's customers would
16 switch to one of the competitors in response to such pricing). ... In fact,
17 the scale and scope economies available to efficient entrants (TRO fn.
18 1536) are generally not consistent with the existence of narrow
19 geographic markets defined along wire center boundaries. [Pleatsikas
20 Rebuttal, p. 6]

21

22 That urban/rural distinction is one of the key reasons why Sprint's
23 proposed market definition (MSA) is a more accurate market
24 definition, because in general MSAs are the more urban areas and
25 non-MSAs are the more rural areas. ... The BellSouth proposal to treat
26 different portions of the CEA differently, based on UNE zones,
27 essentially negates this community-of-interest aspect. Whereas using the
28 MSA as the market maintains the community-of-interest aspect. [Staihr
29 Rebuttal, pp. 2-3, 4]

30

31

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1 Based on sound economic principles and a number of FCC policy
2 statements I conclude-contrary to the position of interveners-that the
3 relevant geographic market is the MSA, not the individual wire center
4 nor the undefined geographic area implied by Mr. Gillan's incorrect and
5 novel notion. In this section I provide the basis for my conclusion.
6 [Taylor Rebuttal, p. 9]
7

8 I recommend that the Commission use LATAs to evaluate impairment.
9 As I noted repeatedly above, the mass market is spread throughout
10 BellSouth's service territory in Florida and any lesser area could
11 potentially camouflage the importance of this fact. However, the
12 evidence (see Table 2) suggests that each LATA is sufficiently
13 comparable to the state overall that the Commission's analysis would
14 not be distorted by using these pre-existing areas in its analysis. [Gillan
15 Rebuttal, p. 15]
16

17 **Q. Have you summarized these and other intervenor positions on the appropriate market**
18 **definition to use in this proceeding?**

19 A. Yes, my Exhibit BFJ-3 contains a table which places each intervenor's market definition
20 proposal into one or more columns. As the quotes just cited confirm, I have placed Dr.
21 Pleatsikas's name into the column labeled "UNE Zones within Component Economic Area
22 (CEA)." I have placed Dr. Staihr's name into the column labeled "Metropolitan Statistical
23 Area (MSA)." I have placed Mr. Taylor's name into the column labeled "UNE Zones within
24 MSA." And I have placed Mr. Gillan's name into the column labeled "Local Access and
25 Transport Area (LATA)."
26

27 **Q. Can you briefly respond to this portion of Dr. Pleatsikas's rebuttal testimony?**

28 A. Yes. Dr. Pleatsikas attacks Dr. Bryant's recommendation that wire centers be aggregated into

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1 geographic market, yet this concept is directly analogous to the approach that is employed in
2 the Department of Justice (DOJ) and Federal Trade Commission's (FTC) Horizontal Merger
3 Guidelines (HMGs). Recall that the approach to defining a geographic market was described
4 in the HMGs as follows.

5
6 In defining the geographic market or markets affected by a merger, the
7 Agency will begin with the location of each merging firm (or each plant
8 of a multiplant firm) and ask what would happen if a hypothetical
9 monopolist of the relevant product at that point imposed at least a
10 "small but significant and nontransitory" increase in price, but the terms
11 of sale at all other locations remained constant. If, in response to the
12 price increase, the reduction in sales of the product at that location
13 would be large enough that a hypothetical monopolist producing or
14 selling the relevant product at the merging firm's location would not find
15 it profitable to impose such an increase in price, then the Agency will
16 add the location from which production is the next-best substitute for
17 production at the merging firm's location. [Id.]
18

19 The substitutability of supply to which Dr. Pleatsikas refers is inherently considered in the "start
20 small and build up" approach used by the DOJ/FTC. In order to define a market in this
21 proceeding, the Commission should start with a wire center and add to it other wire centers
22 with homogeneous characteristics. While there is some merit to trying to determine the point at
23 which "efficient competitors using self-provisioned (or third-party) switching... could... render
24 supracompetitive pricing by the incumbent... unprofitable" there is absolutely no basis for
25 assuming that point is determined by any preexisting large geographic boundary such as a
26 LATA, an MSA or a CEA. To the contrary, the only logical way to find that point is to
27 carefully evaluate the relevant market conditions present in each wire center or small group of

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1 wire centers.

2 Oddly, Dr. Pleatsikas seems to concede the relevance of market conditions within each
3 wire center (or homogeneous group of wire centers) at a later point in his rebuttal testimony:

4
5 As I noted, the competitive entry decision occurs at the market level
6 (which generally would span several wire centers) even if a particular
7 CLEC may elect not to enter a particular wire center (immediately or
8 ever). Accordingly, and in contrast to Dr. Bryant's proposal, a
9 reasonable way of determining whether a particular wire center should
10 be included in a more broadly defined market area depends on whether
11 that wire center's relevant economic/financial characteristics are
12 reasonably homogeneous with those of other proximate wire centers. If
13 they are, then the wire center should generally be included in that
14 broader market area. [Pleatsikas Rebuttal, p. 16]

15
16
17 As I read this statement, it appears that Dr. Pleatsikas realizes that a small group of wire
18 centers with homogeneous characteristics could, as I propose, constitute a valid geographic
19 market definition. In some cases the resulting market area might be similar to the market
20 definitions proposed by BellSouth (UNE rate zones divided by Component Economic Areas),
21 but in other cases they might differ substantially (because market conditions are not necessarily
22 homogenous throughout a CEA).

23 As for Dr. Pleatsikas's contention that CLECs cannot adequately achieve economies of
24 scale and scope in individual or groups of wire centers, I would first note that BellSouth and
25 other parties to this proceeding have not offered any studies to demonstrate the extent to which
26 CLECs can or cannot achieve "scale and scope economies" within individual wire centers, or
27 small groups thereof.

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1 Properly conducted, such a study would consider not only the degree to which
2 economies can be achieved within a particular market, but also the extent to which additional
3 scale and scope economies can be achieved when serving the specified market while also
4 serving other markets. Stated differently, scope economies are frequently achieved by selling
5 goods and services in multiple distinct markets.

6 In general, as a matter of sound economic reasoning it isn't valid to reject a particular
7 set of market definitions merely because this set of definitions separates geographic markets that
8 are distinct from a demand perspective, yet are interrelated from a supply perspective. For
9 instance, the Miami - New York air travel market can legitimately and appropriately be
10 separated from the Miami - Orlando air travel market and the Orlando - New York air travel
11 market. These definitions are valid notwithstanding the fact that airlines may achieve additional
12 economies of scale and scope if they decide to serve all three of these markets (e.g., by
13 scheduling planes to fly triangular routes from Miami to New York to Orlando to Miami and
14 from Miami to Orlando to New York to Miami).

15 While the TRO requires consideration of potential economies of scale and scope, there
16 is no indication that the FCC requires the Commission to artificially ignore the potential for
17 cross-market efficiencies, nor does the TRO state that each individual geographic market must
18 be large enough to exhaust all potential economies of scale and scope, without regard to the
19 physical proximity of other markets, or the potential for achieving additional economies of scale
20 and scope across multiple markets.

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1 **Q. Can you briefly respond to the quoted portion of Dr. Staihr's rebuttal testimony?**

2 A. Yes. Dr. Staihr apparently is under the impression that MSAs are uniformly "urban or
3 suburban." This is not the case. To the contrary, they frequently include rural areas, as well.
4 The Office of Management and Budget (OMB), the government agency responsible for
5 developing MSAs, has cautioned that they are not exclusively urban in character:

6
7 The Metropolitan and Micropolitan Statistical Area Standards do not
8 equate to an urban-rural classification; all counties included in
9 Metropolitan and Micropolitan Areas and many other counties contain
10 both urban and rural territory and populations. [Id.]
11

12 Collectively, the OMB refers to Metropolitan and Micropolitan Statistical Areas as Core Based
13 Statistical Areas (CBSAs). The OMB further states:

14
15 Program designs that treat all parts of a CBSA as if they were as urban
16 as the densely settled core ignore the rural conditions that may exist in
17 some parts of the area. [Federal Register, Vol. 65, No. 249,
18 Wednesday, December 27, 2000]
19

20 While I agree that MSAs often reflect a significant "community-of-interest" that doesn't
21 mean they are economically homogeneous. Because an MSA includes "a recognized population
22 nucleus," it will invariably include a substantial urban component. [Federal Register, Vol. 65,
23 No. 249, Wednesday, December 27, 2000] Since most urban areas include a suburban fringe
24 of bedroom communities, a typical MSA includes a mixture of both urban and suburban
25 markets. Furthermore, in a state like Florida, which includes many rural areas, an MSA may
26 include miles of lightly populated rural areas beyond the suburbs.

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1 For instance, downtown Tallahassee, Crawfordville and Panacea are all in the same
2 MSA, but these do not represent a single homogeneous market from the perspective of a
3 CLEC wanting to use its own switch, nor is the degree of impairment faced by such a carrier
4 likely to be the same throughout this large MSA. Most, if not all, MSAs include widely varying
5 neighborhoods, and they often include multiple towns, cities and counties with widely varying
6 economic and demographic conditions.

7 The danger in defining as this vast area as a single market is that it ignores the extreme
8 differences in operating and engineering characteristics between wire centers within the
9 downtown urban core and wire centers toward the far edges of the MSA. In turn, these
10 differences translate into substantial differences in the cost of using a CLEC switch to serve
11 mass market customers in different parts of the MSA.

12 MCI witness Bryant offered a critique of Dr. Pleatsikas's CEA proposal that is also
13 applicable to Dr. Staihr's MSA proposal:

14
15 If a market as broad as a CEA is defined, differences in profitability in
16 wire centers will be obscured, and the impairment analysis will thus fail
17 to capture any areas where the CLECs cannot profitably provide
18 service. [Bryant Rebuttal, p. 3]
19

20 **Q. Can you briefly respond to Mr. Taylor's rebuttal testimony?**

21 **A.** Yes. Mr. Taylor follows the statement I quote above with four reasons why he believes MSAs
22 are the most appropriate basis for defining a market. Needless to say, I disagree with his first
23 contention—that MSAs are consistent with economic theory. Oddly, in support of this reasoning
24 Mr. Taylor cites the FTC/DOJ merger guidelines. As I explained in my rebuttal testimony,

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1 starting with a large geographic area like an MSA does not comply with the “smallest market”
2 principle that lies at the heart of the HMGs. Mr. Taylor and I are in agreement that the HMGs
3 are consistent with sound economic theory; where we disagree is with our interpretation of the
4 HMGs; I believe a fair reading of the HMGs confirms that the FTC/DOJ approach is more
5 consistent with an approach that starts with an individual wire center then adds other nearby
6 wire centers with homogenous characteristics; it is not consistent with an approach that simply
7 chooses amongst large “off the shelf” geographic areas like CEAs, MSAs or LATAs.

8 I have already refuted Mr. Taylor’s second and third points, regarding fulfillment of
9 TRO guidelines and CLEC entry and advertising patterns, in my rebuttal testimony. I will
10 concede that CLECs do not generally announce the details of their business plans and market
11 entry strategies, a point that was emphasized by Dr. Pleatsikas in his rebuttal testimony.
12 [Pleatsikas Rebuttal, p. 9] However, in Michigan Case No. U-13796, a witness for a CLEC,
13 Sage Telecom, Inc., testified that it does not analyze markets or make entry decisions on the
14 basis of broad MSAs:

15
16 **Q. Does Sage Market its UNE-P based services to**
17 **customers in Michigan based on the Metropolitan**
18 **Statistical Areas defined by the U.S. Office of**
19 **Management and Budget?**

20 A. No.

21
22 **Q. To your knowledge, does anyone in the Michigan**
23 **telecommunications industry market its services to**
24 **customers in Michigan based on the Metropolitan**
25 **Statistical Areas defined by the U.S. Office of**
26 **Management and Budget?**

27 A. No, they do not. In fact, nearly all of those providing basic local

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1 exchange in Michigan, including SBC, market their services
2 based on exchange areas, because central office services,
3 switching, provision of NXXs, and local calling areas are all
4 based on exchange areas. Some carriers appear to market
5 based on wider amalgamations of exchange areas, such as
6 LATAs or Number Plan Areas (also known as Area Codes or
7 NPAs”). [McCausland Direct, Sage Telecom, Inc., Case No.
8 U-13796, December 19, 2003, p. 16]
9

10 Mr. Taylor’s fourth contention is that prior FCC use of MSAs validates their use in this
11 proceeding. I disagree. The FCC has never utilized MSAs in a context like the present one. I
12 concede the FCC has used MSAs for a variety of different analytical purposes, but those
13 proceedings involved entirely different circumstances and issues than are present in this
14 proceeding. Cases related to telephone numbers portability, ILEC mergers, and pricing
15 flexibility for interstate services all involve factual issues that do not vary greatly from wire
16 center to wire center within an MSA. In the context of this proceeding, however, it is not
17 sufficient to speak of the “local exchange market” generally. In this context, the appropriate
18 geographic market relates to a CLEC’s ability to use its own switching facilities to serve mass
19 market customers, and that can vary widely depending upon the circumstances applying to each
20 wire center (e.g., the availability of collocation facilities and the number of enterprise customers
21 present in each wire center).
22

23 **Q. Can you briefly respond to Mr. Gillan’s rebuttal testimony?**

24 **A.** Yes. Mr. Gillan’s proposal is deeply flawed, and creates very high risks for consumers. Local
25 Access and Transport Areas (LATAs), which were initially designated at the end of the AT&T

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1 antitrust case, are even larger geographic areas than MSAs. There are 10 LATAs in Florida,
2 collectively encompassing the entire state. Because LATAs are so vast and heterogenous, they
3 are effectively very similar to defining the entire state as a single market. In the quote above,
4 Mr. Gillan apparently views this as a virtue, noting that a LATA is “sufficiently comparable” to
5 the state as a whole.

6 Recall that the TRO explicitly prohibits defining an entire state as a single market. By
7 utilizing LATAs, Mr. Gillan is offering an approach that avoids this legal prohibition while
8 ensuring a similar end result. LATAs are very heterogeneous, virtually guaranteeing that each
9 market will include a mixture of different circumstances and areas, ranging from places where
10 high levels of impairment exist, to areas where little or no impairment is present.

11 With such a broad geographic market definition, the Commission is forced into an all-
12 or-nothing choice: either the entire LATA will be declared off-limits to competition from CLEC
13 that depend on unbundled switching (because the “trigger” has been pulled in a portion of that
14 vast area), or UNE-P will be preserved throughout the entire LATA because the absence of
15 impairment does not uniformly exist throughout the entire LATA. Perhaps from his clients’
16 perspective an all-or-nothing dichotomy may seem like a reasonable (albeit high stakes)
17 gamble. But from the perspective of customers, it is far too risky an approach. The competitive
18 alternatives available to millions of customers may shrink or disappear if this approach is
19 followed and it is determined that the “trigger” conditions have been fulfilled within a portion of
20 the LATA.

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1 **Mass Market/Enterprise Market Breakpoint**

2

3 **Q. Would you like to respond to any of the rebuttal testimony regarding the breakpoint**
4 **between the mass market and the enterprise market?**

5 **A.** Yes. Verizon witness Fulp, and FCCA witness Gillan testify as follows:

6

7 A fixed crossover point based on a pre-determined number of analog
8 lines, based on some calculation of average costs, would ignore the
9 actual economic choices made by the CLECs and their customers. As I
10 explained in my direct testimony, the Commission should establish that
11 mass market customers are those customers that are actually being
12 served with one or more voice grade DS0 circuits, while enterprise
13 customers should be those customers actually being served by DS1 or
14 higher capacity loops. [Fulp Rebuttal, p. 6]

15

16 In the Verizon territory, I recommend that the Commission accept
17 Verizon's proposal to not impose an artificial upper bound to the mass
18 market. ... Where the ILEC insists that the Commission establish a
19 regulatory "cap" on the mass market, the basic principles on how such
20 a cap should be calculated were included in my direct testimony. My
21 review of the testimony of Sprint's witness Kent Dickerson indicates
22 that Sprint's calculation conforms to those principles and I would
23 recommend the Commission adopt a crossover of 12 lines for the
24 territories of Sprint and BellSouth. [Gillan Rebuttal, p. 16]

25

26 To varying degrees Mr. Fulp and Mr. Gillan argue that the Commission should not use
27 the FCC's default breakpoint of four lines, and that it is not necessary to choose a specific
28 (uniform) alternative. Instead, they suggest the Commission should define the mass market as all
29 customers that are served using analog DS0s. This is an intriguing approach, since it relies on
30 actual customer data, rather than a uniform breakpoint. However, it isn't explicitly permitted

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1 under the TRO. The TRO reads in part:

2
3 Therefore, as part of the economic and operational analysis discussed
4 below, a state must determine the appropriate cut-off for multi-line DS0
5 customers as part of its more granular review. This cross over point
6 may be the point where it makes economic sense for a multi-line
7 customer to be served via a DS1 loop. We expect that in those areas
8 where the switching carve-out was applicable (i.e., density zone 1 of
9 the top 50 MSAs), the appropriate cutoff will be four lines absent
10 significant evidence to the contrary. We are not persuaded, based on
11 this record, that we should alter the Commission's previous
12 determination on this point. Accordingly, we authorize the states, within
13 nine months of the effective date of this Order, to determine the
14 appropriate cross over point. [TRO, ¶ 497]
15

16 At least on its face, this language seems to contemplate defining the mass market on the basis of
17 a specific cut-over point or dividing line—the “point where it makes economic sense for a
18 multi-line customer to be served via a DS1 loop.” The TRO seems to provide some flexibility
19 in defining this point, allowing, for example, consideration of a variety of different revenue and
20 cost data. However, the FCC clearly seems to contemplate a breakpoint that corresponds to a
21 conceptual dividing line, rather than simply sorting customers into markets on the basis of their
22 historic serving arrangements. Thus, for example, if a large bank continues to be served with
23 hundreds of analog PBX trunks, this would not be sufficient to cause the bank to be classified
24 as a “mass market” customer. Interestingly, while Mr. Gillan agrees with classifying customers
25 on the basis of their actual serving arrangements in the case of Verizon, for BellSouth he
26 recommends adopting a breakpoint of 12, as developed in the study conducted by Sprint
27 witness Dickerson.

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1 **Q. What is the impact of using a breakpoint of 12 rather than the FCC’s default**
2 **assumption?**

3 A. The immediate impact is that a larger number of customers will be classified as falling within the
4 “mass market” and fewer will be treated as “enterprise” customers. The ultimate impact will
5 depend on the geographic market definitions adopted by the Commission, as well as the
6 specific criteria that are used by the Commission in reaching its final conclusions concerning
7 whether or not impairment exists.

8 In general, a high breakpoint increases the number of risks facing residential consumers
9 in this proceeding. With a high breakpoint and large geographic market areas, the likelihood
10 increases that millions of residential customers will no longer be provided with any competitive
11 options, or they will have fewer competitive choices, as a result of decisions made in this
12 proceeding. This follows directly from the fact that CLECs that are using their own switches
13 tend to focus on larger business customers; the smaller the customer, and the lower the revenue
14 provided by the customer, the less likely they will be able to serve that customer using their own
15 switch. With a high breakpoint, the likelihood increases that the Commission will conclude the
16 “trigger” has been pulled due to CLEC activity that has spilled over from the enterprise market
17 into the high end of the mass market. In turn, this could lead to a finding of “no impairment”
18 throughout the entire geographic market, despite the fact that no CLECs are economically
19 capable of, or willing to, serve low-revenue customers (e.g. very small business and residential
20 customers) within that market. As a result, competitive options for residential customers will
21 diminish or disappear, because CLECs will no longer be able to use unbundled switching to
22 serve these smaller customers, and they may not be able to use their own switching facilities to

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1 do so.

2

3 **Demand-Based Market Distinctions**

4

5 **Q. In their rebuttal testimony, do any of the other witnesses criticize the concept of**
6 **distinguishing between business and residence product markets?**

7 **A.** Yes. Verizon witness Taylor states as follows:

8

9 In the first place, the TRO makes it clear that the product market the
10 FCC considers relevant for applying its triggers is mass-market local
11 exchange service, irrespective of whether the customers are business or
12 residential: [Quotes cited] [Taylor Rebuttal, p. 36]

13

14 Second, from an economic perspective, the fact that residential and
15 business customers pay different prices for basic service does not imply
16 that those customers purchase services in different markets. ... In other
17 words, Dr. Bryant overlooks the fact that the price differences between
18 residential and business services are the result of public policy and not
19 private profit-maximization, and thus those price differences, by
20 themselves, do not imply that residential and business customers
21 occupy different product markets under the Merger Guidelines'
22 standard. [Id., pp. 37, 39]

23

24 Third, the TRO, itself, outlines some of the economic reasons why all
25 mass-market customers, business and residence alike, belong in the
26 same product market for the purpose of its trigger analysis. In ¶ 459,
27 the FCC spells out the characteristics of these customers that place
28 them in a distinct product market: they are served by DS0 technology,
29 they have small accounts, and they purchase service month-to-month
30 rather than using a term discount. In addition, such customers are
31 served through customer service centers rather than individual customer
32 representatives, their services are marketed using mass-market media

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1 rather than individual, customer-specific marketing, and they buy simple
2 tariffed services rather than packages of network services solicited by
3 formal Requests for Proposals. Residential and business mass-market
4 customers are served using the same technologies (circuit switches and
5 DS0 loops), and thus any supplier of mass-market business services
6 offers and can supply mass-market residential services if a profitable
7 opportunity arises. [Id., p. 39]
8

9 **Q. What is your response?**

10 **A.** None of these quotes from the TRO precludes the possibility of analyzing residential and
11 business customer data separately, or viewing these customers as purchasing telecom services
12 in separate product markets. In fact, I presented a very similar quote in my rebuttal testimony
13 from ¶ 127 of the TRO. In this passage, the FCC discusses the tight profit margins associated
14 with serving smaller customers. This is a crucially important point—one that Dr. Bryant made in
15 his rebuttal testimony.

16 Because business customers generally produce more revenue than
17 residential customers under current pricing practices, a larger
18 proportion of business customers means a larger potential revenue
19 stream for the CLEC. Likewise, the demographic characteristics of the
20 wire center may affect the potential revenue available to the CLEC. A
21 wire center with a large proportion of affluent customers, or a wire
22 center with a large proportion of younger, more tech-savvy customers
23 will likely generate more revenue per customer than wire centers
24 without these characteristics. [Bryant Rebuttal, p. 5]
25
26

27 The tighter profit margins associated with serving residential customers have steered most
28 switch-based CLECs into serving predominantly business customers. In turn, this suggests that
29 important differences may exist between impairment conditions for business and residential

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1 mass market customers--differences that could be overlooked if these customer groups are
2 lumped together throughout the Commission's decision making process.

3 Unless differences in customer characteristics and gross profit margins are adequately
4 considered, conclusions concerning impairment may be reached by the Commission that are
5 only valid for a minority of the mass market customers. For instance, a finding of non-
6 impairment may be reached based on evidence that is only valid with respect to higher revenue
7 small business customers--evidence that isn't valid for lower revenue customers (e.g. those
8 customers generating less than \$80 per month) . Yet, the latter group may include the vast
9 majority of all customers in Florida. Stated another way, unless the Commission takes care to
10 examine data separately for residential customers, or low revenue customers, it may reach
11 conclusions about impairment that are not valid for those customers. This problem is a serious
12 one, since it involves the risk of reaching invalid conclusions for the great majority of all
13 customers in the state.

14 I also disagree with Mr. Taylor's contention that "price differences between residential
15 and business services... do not imply that residential and business customers occupy different
16 product markets under the Merger Guidelines' standard." It is true that residential customers
17 pay lower prices than business customers in part due to public interest considerations
18 (particularly the universal service goal). But "the price differences between residential and
19 business services" are not exclusively the result of public policy considerations, nor are they
20 necessarily inconsistent with private profit-maximization. For instance, private
21 profit-maximization efforts in the airline industry have led to wide discrepancies between
22 business and leisure fares. Hence, for many purposes it is appropriate to distinguish between the

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1 business and leisure travel markets. Furthermore, the mere fact that price differences are partly
2 due to public policy considerations does not eliminate the relevance of those pricing differences
3 for analytical purposes, nor does it imply that residential and business services cannot
4 legitimately be classified as occupying different product markets under the Merger Guidelines'
5 standard.

6 Finally, it is worth noting that in at least one point in the TRO, the FCC seems to
7 suggest that state commissions may refine their market definitions in a manner than ensures an
8 appropriate final conclusion:

9
10 In circumstances where switch providers (or the resellers that rely on
11 them) are identified as currently serving, or capable of serving, only part
12 of the market, the state commission may choose to consider defining
13 that portion of the market as a separate market for purposes of its
14 analysis. [TRO, supranote 1552]
15

16 In addition to resolving the issue of geographic market definitions, the Commission must
17 decide on an appropriate way to distinguish the mass market from the enterprise market, to
18 ensure that the final conclusions are consistent with the overall purpose of the proceeding. In
19 fact, the FCC seems to recognize, at least obliquely, that for some purposes it may be useful to
20 stratify markets with reference to customer characteristics. Consider for instance, this passage:

21
22 As discussed above, the record does not contain sufficient detail
23 concerning which geographic and **customer** markets may in fact allow
24 economic entry. In addition, impairments that exist today in certain
25 markets may be remedied in the future due to the implementation of a
26 batch cut process, as discussed above. Because our standard and the
27 guidance from the *USTA* decision require that the determination of

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1 impairment be made on a granular basis, and because the record
2 provides insufficient evidence concerning the characteristics of
3 particular markets, we find it appropriate to ask the states to assess
4 impairment in the mass market on a market-by-market basis. [TRO pp.
5 493, emphasis added]
6

7 **Q. Has the FCC recognized that customer characteristics may impact the presence or**
8 **absence of impairment?**

9 **A. Yes. For instance, the FCC recognized that customer-specific factors can influence whether or**
10 **not impairment exists:**

11 Mass market customers consist of residential customers and very small
12 business customers. Mass market customers typically purchase
13 ordinary switched voice service (Plain Old Telephone Service or
14 POTS) and a few vertical features. Some customers also purchase
15 additional lines and/or high speed data services. Although the cost of
16 serving each customer is low relative to the other customer classes, the
17 low levels of revenue that customers tend to generate create tight profit
18 margins in serving them. The tight profit margins, and the price
19 sensitivity of these customers, force service providers to keep per
20 customer costs at a minimum. Profits in serving these customers are
21 very sensitive to administrative, marketing, advertising, and customer
22 care costs. These customers usually resist signing term contracts. [Id., ¶
23 127]
24
25

26 In this passage, the FCC recognizes that profit margins in serving smaller customers are
27 tighter than those available when serving larger customers, and this clearly has important
28 implications in determining whether or not impairment exists. While the FCC didn't focus
29 specifically on differences in average revenues per line or per customer, the overall thrust of this
30 reasoning is consistent with an approach which draws such a distinction. As the revenue per

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1 customer declines, it becomes less and less feasible to profitably serve a customer using a
2 CLEC's own switch, because insufficient profit margins exist to overcome the fixed (per-
3 customer) costs of providing service using the CLEC's own facilities.

4 For this reason, one would anticipate that relatively few CLECs will serve residential
5 customers using their own switches. Rather, CLECs that use their own switches primarily focus
6 on serving larger customers—those generating much higher revenues per customer. As the FCC
7 has recognized:

8
9 ...although serving these customers is more costly than mass market
10 customers, the facts that enterprise customers generate higher revenues,
11 and are more sensitive to the quality of service, generally allow for
12 higher profit margins." [Id., ¶ 128]
13

14 Unless these differences in customer characteristics and gross profit margins are
15 adequately considered, there is a great risk of inadvertently reaching conclusions concerning
16 impairment that are only valid for mass market small business customers—conclusions that are
17 not valid for residential customers.

18
19 **Q. Do you have any recommendations with regard to the distinction between residential
20 and business (or low and high revenue) customers?**

21 **A.** Yes. To the extent it is legally permissible, it could be helpful to stratify each geographic market
22 in order to analyze business and residential customer data separately. If this is done, data
23 relating to whether or not impairment exists could be analyzed separately with respect to
24 business and residential customers. Thus, for example, even if there is reason to believe a

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1 “trigger” has been pulled (due to the presence of multiple CLECs) for the small business market
2 or segment, this shouldn’t automatically force the Commission to conclude that the “trigger” has
3 also been pulled for the residential market or segment.

4 Another option would be to further subdivide markets on the basis of revenue per
5 customer, or on the basis of gross profit margin per customer (revenues minus direct costs), to
6 the extent this is necessary to ensure that a finding of non-impairment is not erroneously applied
7 to customers that cannot feasibly be served using a CLEC’s own switch. This could lead to
8 more accurate and homogenous market classifications than a system based purely on the
9 number of lines used by each customer (e.g., the number of DS0 lines).

10 For instance, if the Commission concluded that customers generating revenue of less
11 than \$80 per month cannot feasibly be served using a CLEC’s own switch, it could potentially
12 segregate these customers from the remainder of the “mass” market, at least within certain
13 geographic markets. A revenue-based distinction might enable the Commission to take into
14 account differences in underlying market conditions, including typical rate structures, rate levels,
15 and gross profit margins associated with different types of customers. This is consistent with
16 language in the TRO that requires state commissions to take into account “the variation in
17 factors affecting competitors’ ability to serve each group of customers, and competitors’ ability
18 to target and serve specific markets economically and efficiently using currently available
19 technologies.” [Id., ¶ 495]

20 Regardless of what specific approach the Commission ultimately adopts, it should take
21 great care to ensure that its decisions do not prevent CLECs from serving low revenue
22 customers. CLECs should be allowed to continue using switching UNEs to serve low revenue

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1 customers if it isn't economically feasible for them to serve these customers using their own
2 switch.

3

4 **Q. Does this complete your surrebuttal testimony that was prefiled on January 28, 2004?**

5 **A. Yes, it does.**

1 BY MR. BECK:

2 Q Dr. Johnson, have you prepared a presentation
3 concerning the testimonies that you filed?

4 A Yes, I have.

5 Q It's all yours.

6 A Thank you very much. It's going to be broken into
7 five areas. First, I'm going to talk briefly about some
8 background to provide context that I think may be useful at
9 this stage. Secondly, I will talk about the geographic market
10 definitions. Third, about the distinction between the mass
11 market and enterprise market. Fourth, I will talk about
12 demand-based market distinctions. And, finally, if time
13 permits, I will summarize my recommendations.

14 As you know, the TRO includes a national finding of
15 impairment for mass market switching, but the FCC delegated
16 responsibility to this and other state commissions to determine
17 more granular market-specific impairment conditions, or whether
18 a lack of impairment exists in certain specific granular
19 markets.

20 And they have asked the Commission to do it in a
21 three-step process. First, you are lacking at -- and the most
22 important one in this proceeding -- what is called the
23 self-provisioning trigger. Whether or not there are three or
24 more unaffiliated CLECs that are serving mass market customers
25 in the particular market. Also, you can look at whether a

1 wholesale trigger of two or more wholesale suppliers are
2 present, and there is also a potential deployment trigger based
3 on economic modeling and review of other facts.

4 The key Commission responsibilities are set out at
5 Paragraphs 495 and 496 of the TRO, as well as 497, where the
6 FCC explains that you will need to define the markets that will
7 be used in these trigger analyses, and also to more precisely
8 define, if necessary, the mass market. And once you have done
9 those definitions, then the remaining step is to determine the
10 extent to which impairment exists in each specific market given
11 the parameters of that market and the various parameters set
12 forth in the TRO.

13 Now, there are important consequences to this process
14 which is easy to lose sight of. To the extent nonimpairment is
15 found in specific markets, it might reduce or eliminate
16 competitive options for customers in those markets. It might
17 also increase CLEC costs leading to higher rates to be charged
18 by CLECs. The greatest impact will be in those instances where
19 a lack of impairment is found, but that lack of impairment is
20 actually unique to certain types of CLECs or certain types of
21 customers within that market.

22 Turning to the key issue of the geographic market
23 definitions, the other parties' proposals are worth briefly
24 summarizing. First, at one end of the spectrum with the
25 largest proposed definition is the position of most of the

1 CLECs in this proceeding as collectively presented through the
2 FCCA, and they are proposing the use of a LATA, and they
3 frankly explain that one of the advantages of that is it is
4 very similar to using a statewide market definition.

5 The second broadest definition is the one offered by
6 Sprint, another one of the CLECs, as well as an ILEC in the
7 state, and they are proposing the use of metropolitan
8 statistical areas, or MSAs.

9 Towards the middle, but still very broad is the
10 proposal of Verizon to use UNE rate zones divided by MSAs, or
11 sort of the intersection of MSAs and rate zones. And very
12 similar to that is the BellSouth proposal to use UNE rate zones
13 divided by component economic areas.

14 Finally, MCI at the lowest end of the spectrum, or
15 the narrowest market definition is recommending the use of
16 individual wire centers. The citizens, and through my
17 testimony we are suggesting to you something towards the lower
18 end of that spectrum, but it is a little different than MCI,
19 but very close to MCI, and that is to start with individual
20 wire centers, but to group them to the extent there are
21 homogeneous wire centers near each other that can form logical
22 geographic markets.

23 Those groupings, or small groups of wire centers,
24 would be the ultimate market definition to use for the actual
25 process, because to the extent an individual wire center is

1 close to other wire centers that have homogeneous
2 characteristics, what you find within that one wire center can
3 reasonably be interpreted as representative of that entire
4 small market area.

5 The bulk of my testimony is concerned with the
6 disadvantages of using very large market areas and the
7 disadvantages of going too broad with this process. The key
8 problem is that they are not sufficiently granular in order to
9 achieve what the FCC is asking this Commission to do, and
10 ultimately what the federal judiciary has asked the FCC to do.

11 More specifically, to the extent you have
12 heterogeneity within that large area, such as an MSA, it
13 increases the risk that you will reach a finding of impairment,
14 whether nonimpairment or impairment, that is only valid for
15 some parts of that overall area. If you have differing
16 economic and cost characteristics within the broad area, or
17 differing demand and demographic characteristics, then whatever
18 evidence you settle upon and ultimately conclude that the
19 trigger is or is not pulled for that broad area isn't
20 necessarily representative of the actual situation.

21 It is actually quite similar to the problem with the
22 FCC's finding of nationwide impairment, because as the evidence
23 comes out in the various states there are exceptions to that
24 broad general finding. Some instances in which the facts are
25 quite different than what the FCC looked at generally. The

1 same problem can happen within a state if you use a large
2 market area, such as an MSA.

3 I also point out that the OMB, which is the federal
4 agency that defines the MSAs and updates them from time to
5 time, has warned the public that there is heterogeneity within
6 MSAs, and that they do include rural as well as urban and
7 suburban areas. And I would point you to the maps at Pages 3
8 and 4 of my rebuttal exhibit to show you that the MSAs that
9 encompass, for example, Tampa are very broad areas that anyone
10 that is familiar with that area knows it encompasses areas that
11 are essentially rural in character, very lightly populated,
12 unlikely to attract competitors. As well as densely populated
13 areas, like downtown Tampa.

14 I also talk about the horizontal merger guidelines,
15 not because they are a specific mechanism that you can adopt
16 here, but because they do provide some insight and guidance
17 into a general approach that I would recommend you use. And
18 that approach is what I call the smallest market principle, or
19 start small and build up. And it is at the essence of what the
20 FTC and DOJ do with their horizontal merger guidelines.

21 And bear in mind that unlike this impairment process,
22 which is really a matter of first impression for this and other
23 state commissions, the horizontal process for antitrust reviews
24 has been perfected over a period of time. And they have found
25 that starting with very small and narrowly defined, very

1 precise, tightly defined markets and then building up to the
2 extent they find additional products or additional geography
3 that is homogeneous and similar to that, and that has similar
4 economic characteristics in that antitrust context, you settle
5 upon a larger more practical market to work with rather than
6 having to look at each and every individual product being sold
7 by two firms that are proposing to merge.

8 What I am suggesting is that same basic approach
9 should be used here. That you would be well advised to start
10 with the individual wire centers, which is the lowest level of
11 detail that is readily available for statistical purposes, and
12 you look at those and determine whether there are adjacent wire
13 centers that have homogeneous characteristics, similar numbers
14 of collocations. And by collocation I mean including IXC
15 collocations, all types of collocation. Similar numbers of
16 enterprise customers, similar density levels. If you find
17 homogeneity, then you group those together, because whatever
18 you found in any one of those wire centers reasonably could be
19 concluded to be applicable to the remainder.

20 But as you go out from the inner city and go into the
21 suburbs or into rural areas, you will find tremendous changes
22 and it is no longer homogeneous, and it would be appropriate to
23 group those separately as separate markets to be analyzed in a
24 separate step of the process.

25 Now, more fundamentally this entire approach, even

1 though the number of markets in the state may be very similar
2 to the one being used by BellSouth, is a more effective process
3 that will be more precise and more successful for you. The
4 approach being used by BellSouth and Verizon, and for that
5 matter Sprint, or even FCCA, is fundamentally the opposite. It
6 starts with the entire state, or it starts with a very broad
7 statistical predefined boundary, such as an MSA or a LATA, and
8 if it does any further steps at all it cuts down towards a
9 subdivision of that, such as the UNE rate zones. Or vice
10 versa, they start with the entire state's three UNE rates zones
11 and subdivide by CEAs.

12 It is fundamentally the opposite approach, and the
13 problem with it is not how many markets they find, but whether
14 the resulting markets are truly homogeneous. So can you trust
15 the findings you find of a behavior of particular CLECs in
16 portions of that market that they are going to be indicative of
17 what can happen throughout the market once UNE-P is removed
18 from being available.

19 The key problem is that you are supposed to be
20 considering detailed factors like the locations of customers
21 who are actually being served, if any, by the competitors. And
22 that is a quote from Paragraph 495 from the TRO. You are
23 supposed to be considering scale and scope economies, but those
24 fundamentally are determined through an entry process that
25 focuses on wire centers.

1 In general, if you start with very large area
2 definitions, you will inadequately distinguish -- and this is
3 again a quote from the TRO, Paragraph 495 -- distinguish among
4 markets where different findings of impairment are likely.
5 This is the absolute essence of the problem.

6 If you average a river that has sections that are two
7 inches deep and sections that are 12 feet deep, you cannot
8 reach a sound conclusion as whether you can walk across or wade
9 across the river, or whether you are going to need a boat. It
10 is that same basic problem when you start looking at something
11 that is too broad and that is heterogeneous, you can't have
12 confidence that the currently observed empirical data is
13 representative of what will happen when you remove UNE-P from
14 the market.

15 I would point out that to the extent some are
16 suggesting that the CLECs cannot adequately achieve scale and
17 scope economies through this approach of focussing on
18 individual markets, I discuss at some length in my prefiled
19 testimony the fact that scale and scope economies by their very
20 nature involve multiple markets, that firms, carriers serve
21 multiple markets, different types of customers.

22 Furthermore, there has been absolutely no study or
23 proof that a large area, such as a LATA, is needed in order for
24 a CLEC to achieve scale and scope economies. That they are
25 unable to serve multiple markets and achieve, for example, the

1 efficiencies of using an OSS. And really to the contrary,
2 those economies can be achieved even if you define markets
3 narrowly in the manner I'm talking about with groups of wire
4 centers of homogeneous characteristics.

5 Now, there has been some discussion of market entry
6 decisions, and that is one of the points of contention and
7 whether or not it is appropriate to define the markets as
8 individual wire centers or small groups of wire centers with
9 homogeneous characteristics. And the key point is that in
10 reality entry decisions are often made using the revenue to
11 cost considerations, the degree of profit margin that is
12 available. And those considerations vary at the wire center
13 level. It is to some degree reflected in the BellSouth
14 approach when they concede that the UNE rate zones are relevant
15 and they need to be considered because the profit margins are
16 lower in those areas where the loop rates are higher.

17 However, it should also be noted that it is very
18 clear, anyone familiar with the industry would know that the
19 CLECs tend to locate their switches in areas where they can be
20 serving. And, in fact, their marketing efforts target
21 enterprise customers, high profit margin customers. There is
22 very few exceptions to that. Generally, the CLECs that put in
23 switches are primarily serving the enterprise customers. And
24 those tend to be located in specific places, higher density
25 areas, downtown urban areas and the like.

1 The other concern as to large area definitions is
2 that entry doesn't, in fact, necessarily occur throughout an
3 entire LATA or an MSA in one fell swoop. So that is really not
4 a -- that is sort of a false basis for choosing the LATA or the
5 MSA. The reality is that entry consists of a series of
6 decisions, and those decisions are tied very specifically to
7 the profit margins or the revenue relative to cost
8 calculations. Which again can vary by individual wire centers,
9 and certainly more importantly can vary geographically from
10 different parts of the state or different parts of an MSA.

11 The customer mix which is available within specific
12 wire centers can also influence entry decisions. If there
13 aren't enough enterprise customers, CLECs may not be attracted
14 to the market regardless of any other factors that might be
15 present. And, again, the fact we are focussing on enterprise
16 customers is not in any way incorrect here, because that is the
17 process. Typically what happens, and is well recognized is
18 that they are primarily serving the enterprise customers. The
19 key question is if we no longer have UNE-P available will the
20 CLECs start expanding into serving those types of customers who
21 are currently served with UNE-P with that switch.

22 In other words, will they say, well, the second best
23 choice is to start using my switch to serve smaller business
24 customers, those who are below my current cutoff, or those that
25 I am currently only serving using UNE-P. That is the key

1 question that the FCC needs you to figure out, because they
2 have seen on a broad brush basis a distinction between the
3 enterprise and the individual smaller customer market, the
4 so-called mass market.

5 Now, the key thing also to bear in mind here, it is
6 very interesting the way you have set up your proceeding and
7 split it into two pieces, because in a sense the two parties
8 that are groups of parties that are spending most of the time
9 with you and have the most immediate direct impact on their
10 operations or the outcome of this proceeding sort of share a
11 sense of wanting large markets. What they disagree on is
12 whether that large market should then in turn be declared as
13 completely full or completely empty. The reality is the glass
14 is half full, and that is a very subtle problem to deal with.
15 The broader the market, the more a victory or a loss in Florida
16 helps them or hurts them, and they are obviously hopeful that
17 their advocacy efforts will be successful.

18 The problem from the Commission's point of view is to
19 do what the FCC wants you to do. It is very difficult to
20 achieve that if you, in essence, are dealing with such broad
21 brush categories that it essentially becomes a vote, 50 states
22 decide whether they are going to agree or disagree with the
23 default finding of impairment for mass market and nonimpairment
24 for enterprise. And I don't really think that is what the
25 judiciary really is seeking here.

1 When they said they want a more granular approach,
2 and the FCC says we are needing a more granular approach from
3 the states, surely they are looking for something that is down
4 at the state specific level, the details of individual markets,
5 individual neighborhoods, if you will. Individual cities that
6 only state commissions can know. And that is the essence of
7 the exercise that you need to do here even though many of the
8 parties, perhaps virtually all the parties here have somewhat
9 different agendas.

10 The key question is that if the defined markets are
11 sufficiently homogeneous then you are minimizing the risk of
12 adverse or unintended consequences. Which is, of course,
13 always the problem with government intervention in markets is
14 you get these unintended consequences. The goal here is to
15 minimize those and, in fact, to achieve what the Congress
16 ultimately in the '96 Telecom Act is seeking.

17 By analyzing the data at the wire center level and
18 then aggregating up where homogeneity exists, you can much more
19 precisely determine where the impairment exists and where it
20 does not exist. With this more granular analysis, you can have
21 greater confidence that the findings you are making are going
22 to be valid with respect to all carriers and all customers.

23 So removing UNE-P will not have a serious adverse
24 effect if it is done in that manner and it is very carefully
25 done so that you are confident that the behavior of the

1 existing three triggering carriers is indicative of what other
2 carriers are capable of doing. That they are, in fact, capable
3 of putting in a switch or taking an existing switch and
4 starting to use it to serve mass market customers.

5 The more heterogeneous the market, the less
6 confidence you can have that the conclusions you are reaching
7 will be valid and will not cause a drastic reduction in the
8 overall level of competition in the state. This is surely not
9 what the FCC was seeking and certainly not what the federal
10 judiciary was seeking when asking the FCC to be more precise in
11 its whole approach to impairment.

12 Now, according to the ILECs, if a trigger is pulled
13 in any portion of a large market area, then that entire area
14 should be deemed free of impairment. And, again, I think you
15 see the essence of that problem. That is really not the heart
16 of what is being asked here. The question is whether the
17 behavior of, say, an FDN and the way they are acting in the
18 particular markets they are entering, are those indicative of
19 what, say, an AT&T is capable of doing in the future if it
20 becomes necessary for it to.

21 According to the witnesses that are arguing for large
22 area definitions, and who are trying to find that the
23 impairment exists throughout that entire large area, it is
24 really just the reciprocal of the same philosophy. They are
25 asking you to look at specific evidence of, say, a lack of

1 participation by most of the CLECs, or a lack of intensity of
2 mass market activity as indicative of that entire market area.

3 These are parallel positions and in some ways you
4 might think it is a nonissue what the geography is. Let's just
5 use these large areas and move on to whether it is impairment
6 or nonimpairment. But, again, I think that doesn't serve the
7 best interests of the public, it doesn't serve the best
8 interests of the citizens of the state.

9 The key question in this parallel process is that,
10 you know, from the point of view of the parties that are
11 advocating their respective positions, they get the biggest
12 home run out of the ballpark. But from the point of view of
13 the public there is this real concern that you will find, for
14 example, a finding of a lack of impairment based on activity in
15 downtown Miami, and then generalize that throughout the entire
16 Dade or Dade and Monroe area. And, again, that could
17 ultimately be very adverse to the interests of the citizens.

18 And really the reverse is also true. If you conclude
19 based on the entire LATA there is just not enough activity,
20 there is not enough evidence that the national default position
21 should be overcome, you run the risk that we are not
22 sufficiently withdrawing UNE-P where it should be withdrawn and
23 encouraging additional investment in the state and additional
24 switch-based competitive activity.

25 Let me turn now briefly to the question of this

1 distinction between the mass market and the enterprise market.
2 This is one of these difficult issues that you don't have as
3 many tools available to you perhaps in the TRO as would be
4 desirable. The FCC used four lines to draw this distinction.
5 And that customers above the break point are presumed to be in
6 the enterprise market, those below that break point are in the
7 mass market.

8 There are alternative proposals in the proceeding.
9 Sprint in particular is suggesting using 12 lines based on a
10 cost analysis. Setting that higher break point, such as 12,
11 would seem to be within the Commission's discretion given some
12 language in the TRO that points to -- and I will point to
13 Paragraph 497 where it says, "at some point," and goes on to
14 say there is a sufficient number of lines being used by a
15 customer, that even though they are currently served in a DSL
16 manner they could be treated the same as an enterprise
17 customer.

18 So it may be within your discretion to go to 12, and
19 it does have some beneficial effects. I will be very specific
20 about what those beneficial effects would be. It does expand
21 the number of small business customers that will continue to
22 have UNE-based competitive alternatives in markets where few,
23 if any, switch-based CLECs offer service. Or put another way,
24 it reduces the impact of the blanket nonimpairment finding for
25 the enterprise category.

1 In other words, we have areas of the state that
2 enterprise customers are presumed to be nonimpaired, but is
3 that truly going to be valid when you get to some of the nooks
4 and crannies of the state, the more rural parts of the state.
5 So there could be customers of 5, 9, 11 lines that would get
6 some benefit of having additional UNE-P options available to
7 them if you switch this break point.

8 On the other hand, there are some disadvantages or
9 some risks, if you will. It increases the chances that
10 residential and very small business customers, and by that I
11 mean the ones, you know, four, three, two, one line customers
12 will not have any competitive options at the end of this
13 process.

14 Or put another way, the trigger may be pulled in an
15 entire market, yet that doesn't necessarily mean -- there is
16 nothing about this process that guarantees that the extremely
17 small customer, the one line business customer, the one line
18 residential customer who doesn't use features or very many
19 features, doesn't generate a lot of revenue is going to have
20 any competitive alternatives.

21 One of the possible consequences of this entire
22 process is where you find a lack of impairment exists under the
23 FCC's rules you may ultimately have a result in which
24 competitive alternatives will be withdrawn. UNE-P will no
25 longer be available, carriers won't make enough money on the

1 pure resale approach and they will simply withdraw from the
2 market.

3 If you shift this dividing line between the
4 enterprise and the mass market, it has subtle effects on those
5 risks. For example, an entire market might be declared as
6 unimpaired because of some seven line customers activity that
7 these counts you have been looking at are all based on the
8 presumed four line demarcation. The counts may shift, the
9 number of CLECs may shift because of these gray area customers
10 who are above four and below 12.

11 In general, the biggest concern is that the CLECs
12 that remain in the market may need to increase their rates in
13 order to recover the cost of installing a switch, a collocation
14 cage, a backhaul network, or they may withdraw from the market
15 in its entirety. That they are currently serving one and two
16 line customers, three line customers, they may ultimately leave
17 the market when UNE-P is no longer available.

18 To some degree that is an unavoidable consequence of
19 the structure of what the FCC has handed you with, but there
20 are ways that in looking at this analysis, looking at it very
21 carefully you can certainly try to minimize the number of
22 customers who are adversely affected. You can try to minimize
23 those risks. Get a controlled experiment, if you will, but
24 have one that is truly controlled and not out of control.

25 I am almost out of time, but let me very briefly

1 refer to the subtlety of demand-based market distinctions and
2 remind you that in my prefiled testimony I have referred to the
3 options that I believe are available under the TRO based on
4 Paragraphs 461, 493, 127, and most notably of all, Footnote
5 1552 to the TRO, where it clearly says that market definitions
6 can be refined if necessary, so that, in essence, an
7 appropriate final conclusion is reached.

8 You would have to look at the footnote very
9 carefully, but I do believe they have given you the authority,
10 although I don't think they realized the full degree you might
11 need to use that authority. They have given you the authority
12 if you find that having defined a market through the basic
13 process there are some exceptions to that market, there are
14 sections of the market, geographic or otherwise, that the
15 activities, the characteristics are fundamentally different,
16 there is no evidence that CLECs are willing to serve that part
17 of the market, then you can make an exception and, in essence,
18 refine the market to separate out that pocket that is sort of
19 the anomaly, or that is contrary to the basic definition.

20 Now, I will admit the TRO doesn't specifically say
21 you can do that to separate in certain cases residential from
22 business customers. But I believe that would be a reasonable
23 interpretation and within your discretion should you choose to
24 do so. Admittedly, the TRO is primarily focussing on
25 geography. But, again, there is no -- that I can tell there is

1 no explicit prohibition that prevents you from on a very
2 careful selective basis drawing additional distinctions where
3 you feel it is necessary.

4 Finally, the Commission has a need to look very
5 carefully at this entire process. You cannot treat it simply
6 as a cut and dried mechanical exercise. All the states are
7 facing the same problems at the very time. There is very
8 little guidance to go on in terms of how other states are
9 treating the issues, or for that matter how the FCC will
10 ultimately readjust or refine this process. We are at the
11 beginning of the process akin to quite some years ago in about
12 '97 when we were all starting with the beginning of the TELRIC
13 process and it evolved quite a bit over the subsequent years.

14 Core principles I will leave you with, and I hope you
15 will choose to use. I believe it is wise to start small and
16 build up in dealing with your markets. The mere count of
17 markets is not the only factor to consider. You also need to
18 consider whether those are homogeneous and logical markets.
19 Also, I believe that the CLECs' ability to target these
20 specific markets, their actual pattern of entry is important
21 and needs to be looked at very carefully.

22 You should take care in setting the break point
23 between the mass market and enterprise. And I'm not really
24 advising you specifically whether you should deviate from the
25 default. If you don't see strong evidence to deviate from the

1 four, I would suggest you leave it in place. But you should
2 look at that issue carefully because it is a subtlety that will
3 become clear to you as you look at the remainder of your
4 evidence and how are the final outcomes affected by that
5 assumption that you are going to use four as your breakpoint.

6 And, in particular, I would ask you to look very
7 closely at data for residential separately from small business.
8 Even if you ultimately conclude that the small business
9 activity is indicative of what can happen to residential in the
10 future, make that a conscious decision. Think about the
11 question.

12 If you see evidence that none of the carriers or only
13 one of the carriers present is serving any significant number
14 of residential customers, and they are almost entirely focussed
15 on small business customers, then do think through the
16 potential consequences of reaching a finding of nonimpairment
17 based on business activity and applying that to the residential
18 market thereby removing the UNE-P option for carriers who are
19 interested in serving residential customers.

20 I think we have just about used up the half hour and
21 I thank you very much.

22 MR. BECK: Mr. Chairman, we will cede the remainder
23 of the time to the AARP.

24 CHAIRMAN BAEZ: Okay. And by my count I've got
25 exactly 30 minutes at this point. Mr. Twomey. Thank you, Mr.

1 Beck. Thank you, Dr. Johnson.

2 MR. TWOMEY: Mr. Chairman, Commissioners, thank you.
3 Mike Twomey on behalf of AARP. I want to apologize, I'm
4 feeling a little bit lightheaded. I think I'm getting sick,
5 but I want to go through a statement I have and read it as best
6 I can.

7 Mr. Chairman and Commissioners, to some degree the
8 AARP questions the FCC's jurisdiction to have you undertaking
9 this task. Clearly others do, as well, and I suppose it is
10 possible within a matter of days that the D.C. court could
11 issue an order rendering most of what you are doing moot.

12 However, in the event that this case is not mooted,
13 AARP believes this case has critical implications for the level
14 of competition residential customers will continue receiving
15 that they have now and that they might experience in the
16 future. AARP believes it is essential for this Commission to
17 exercise the discretion it has under the TRO to ensure that the
18 fewest number of residential customers are left geographically
19 stranded with no reasonable near term potential for receiving
20 economically reasonable competition. AARP believes that there
21 are promises that have been made to residential customers
22 regarding the availability of competition for many years now
23 that are in danger of being reneged on.

24 Let me briefly tell you how AARP believes we got to
25 where we are today, what we have today in the way of

1 competition, and lastly where we fear this proceeding may lead
2 us. As you all are aware, although I think only Commissioner
3 Deason was on the Commission at the time, the ILECs were
4 legally protected monopolies until the 1995 state legislation
5 that subjected them to competition in exchange for an escape
6 from profit regulation, amongst other things.

7 The 1996 federal legislation was passed with the
8 goal, among other things, of increasing local service
9 competition. At least as early as the session of 2002,
10 virtually all of the telephone parties to this case were
11 petitioning the legislature for access fee legislation which
12 had the potential of substantially increasing basic local
13 rates, especially residential rates.

14 One of the several justifications for raising local
15 residential rates was that the increased rates would provide a
16 greater likely profit margin to potential competitors which in
17 turn would kick start the long promised residential competition
18 that had never materialized to the degree it had been promoted.
19 That is, the companies told the legislature that there was not
20 enough competition and that large percentage rate increases
21 would likely fix the problem.

22 Those companies, again, virtually all of them in this
23 room, prevailed with the legislature in the 2003 session. In
24 late 2003, just last year, these same companies essentially as
25 a consortium petitioned this Commission for some \$355 million

1 in annual rate increases. As they had told the legislature,
2 they also told you that the increased rates would among other
3 things increase or enhance the potential for residential
4 service competition.

5 You approved over \$344 million in annual rate
6 increases, over 90 percent of which will be paid by residential
7 customers. Your order speaks to the potential increased rates
8 will play in hopefully promoting local service competition.

9 Your just completed 2003 report to the legislature on
10 competition, which is Exhibit 82 in this case, was also
11 included in the access case record as an exhibit. I want to
12 briefly recite to you some of the things that your report to
13 the legislature says to the legislature and the public in
14 general on the status of competition in the State of Florida in
15 the year 2003.

16 That report, Commissioners, said with respect to the
17 three available means of competitors coming in an ILEC's
18 market, of the first, resale, that your report said those CLECs
19 that focus on serving customers who have been disconnected by
20 the ILEC, or who refer prepaid service, may view resale as a
21 long-term strategy. It spoke to unbundled network elements.

22 And then speaking to facilities-based competition,
23 your report said in part, "Frequently CLECs enter the market
24 using resale or UNE-based services while investing the
25 financial resources necessary to build a telecommunications

1 network and eventually provide facilities-based services
2 independent of the ILECs. Many CLECs have chosen a UNE-P or
3 resale platform, and true facilities-based competition in the
4 local telecommunications market is not yet widespread."

5 Your report noted that CLECs' residential market
6 share had increased to 9 percent last year from 7 percent the
7 previous year, and it noted as well that the majority of those
8 customers are in BellSouth's territory and predominately in the
9 urban areas served by BellSouth.

10 The report also noted that the CLECs' residential
11 customers in the year 2003 were up to 270 -- pardon me,
12 726,638, up from 366,653 in 2001, two years earlier. However,
13 of that number fully 668,261 were taken from BellSouth's
14 service territory, while only 32,175 were in Sprint's
15 territories, and 23,772 from Verizon. The rural LECs had a
16 little more than 2000 residential customers lost to CLECs.

17 Your report went on to note that the top ten
18 exchanges with the most CLEC providers were all located in
19 BellSouth's service territory. The report said on CLECs, it
20 said CLECs concentrate on larger metropolitan areas for a
21 number of reasons, including higher population densities, which
22 improve economics of scale and scope. Lower UNE rates in these
23 higher density zones also attract competitors. Notably, each
24 exchange shown in Table 4, that is the top ten, is in
25 BellSouth's territory. One explanation of the greater CLEC

1 presence in these exchanges is that BellSouth has the lowest
2 UNE-P rates among all the ILECs.

3 The report goes on at Pages 12 and 13, and says that,
4 "As stated earlier, the availability and price of UNEs,
5 especially UNE-P, are key determinants of CLEC market entry.
6 UNE-P appears to be the entry strategy of choice for many CLECs
7 serving the mass market, i.e., residential and small business
8 customers." It goes on to talk about how you all lowered their
9 UNE-P rates over time to the rate they are currently.

10 Your report goes on to say that BellSouth's level of
11 competition is clearly related to its UNE-P rates, which were
12 established much earlier than those for Sprint and Verizon and
13 which are very much lower than those of the other two ILECs in
14 the largest rate zones. 48 percent of total CLEC access lines
15 are UNE-P lines in BellSouth's territory alone, while UNE-P
16 comprises only 3 percent of the CLEC lines in Verizon's
17 territory and only 5 in Sprint's.

18 Your report goes on to say that UNE-P lines in
19 BellSouth's territory have increased significantly over the
20 last three years, while resale lines have declined. They have
21 declined dramatically, and they have transitioned, resale has
22 transitioned to UNE-P as the preferred way to go.

23 A little more from the report. The report, I think
24 it is at Page 17 says in Florida 73 percent of CLEC residential
25 lines are served via UNE-P. 73 percent, Commissioners, of CLEC

1 residential lines are served by UNE-P, the very methodology
2 that BellSouth and Verizon are trying to do away with at rates
3 regulated by you in very large portions of this state.

4 Your report goes on to say where UNE-P has become the
5 prevalent method of market entry, proponents of UNE-P argue
6 that UNE-P is critical to ensuring competition in the local
7 telecommunications market and that it must be preserved.

8 Your report notes, as has been conceded here, that
9 the FCC presumptively presumes, that is they presume that
10 markets are impaired unless the proponents prove otherwise to
11 your satisfaction. The report goes on to note that Sprint
12 recognizes the importance of UNE-P availability as is obvious
13 here by announcing its plans to go nationwide including
14 throughout Florida offering UNE-P competition.

15 As of June 30th, 2003, your report says there were 30
16 CLECs serving 992,990 lines in Florida. However,
17 Commissioners, your report notes that fully 90 percent of those
18 lines were business customers. Your report makes it clear that
19 competition to the extent that we have attained it in Florida
20 for residential customers is almost totally the result of UNE-P
21 availability. The report shows, I think, conclusively, that
22 UNE-P, that residential competition in this state didn't really
23 start to take hold until your decisions affecting BellSouth's
24 UNE-P rates. I think the evidence is conclusive.

25 If the Commission's decision in this case results in

1 the widespread unavailability of UNE-P at Commission regulated
2 TELRIC prices, it seems clear to the AARP that the narrow
3 foothold, the mere 9 percent statewide of residential
4 competition, is going to be disappearing to a large degree.

5 I mean, I think it is clear that those people came in
6 because of the availability of UNE-P at the current rates. If
7 the rates increase to market rates, they would go from less
8 than \$2 to \$14. It seems almost mathematically conclusive that
9 those people, some of them will go out of the market, and the
10 people that are residential customers, including AARP members
11 that are receiving competitive service over the 27-month
12 transition period will be left without it. To the extent --
13 and that what we have now will decline.

14 Furthermore, AARP is concerned that to the extent
15 that there were providers like AT&T and Sprint and others that
16 tended through their plans to come into the State of Florida
17 and compete with BellSouth and Verizon and the others utilizing
18 UNE-P at the current rates, are less likely clearly to do so if
19 the UNE-P rates, regulated rates are not available.

20 Now, it seems beyond doubt with the TRO that this
21 Commission is going to be compelled to find the trigger met in
22 certain areas. Where there is three trigger CLECs proven, you
23 have no choice as I see it. What AARP would urge you to do in
24 those cases is exercise the discretion that the FCC has granted
25 to you and constrict the geographic area to the greatest extent

1 possible around those trigger switches. For the reasons that
2 Dr. Johnson just gave you, that will leave fewer people at risk
3 than if you engage in selecting larger geographic areas.

4 If it turns out that there is actual active
5 competition in the geographic areas, the smaller areas that we
6 urge you to pick, and it blossoms, there is nothing to stop it
7 from spreading beyond the geographic areas that you select.
8 But in the meantime those people in the areas not -- that are
9 not found not impaired will have access potentially to
10 competitors that would have the UNE-P at regulated rates.

11 So, in conclusion, AARP would ask you to exercise
12 your discretion in the manner suggested by Dr. Johnson in a
13 manner that will leave potentially the fewest residential
14 customers in this state stranded without the potential access
15 to residential competition. Thank you.

16 CHAIRMAN BAEZ: Thank you, Mr. Twomey. We have got
17 an hour of cross, I guess, for Dr. Johnson. Are any of the
18 parties --

19 MR. LACKEY: BellSouth is certainly willing to pass
20 if everybody else does.

21 CHAIRMAN BAEZ: There is no cross for Dr. Johnson?

22 MR. HENRY: The only reason I came to the table is
23 because Mr. Lackey came to the table, so --

24 CHAIRMAN BAEZ: I see, a little man-to-man. I can
25 appreciate that come March. Ms. McNulty.

1 MS. McNULTY: None from me.

2 CHAIRMAN BAEZ: Okay. So it is fair to say that none
3 of the parties have cross-examine. All right. Thank you very
4 much. Well, we have -- you have a question for Dr. Johnson?
5 Okay. Where is Dr. Johnson? There he is.

6 COMMISSIONER DEASON: The question I have is
7 concerning a specific proposal. Have you had the opportunity
8 or have you formulated a specific plan where you have
9 determined the degree of homogeneity for particular wire
10 centers and how those would be grouped, or are you just leaving
11 that to the Commission to ascertain or determine?

12 THE WITNESS: Given the time lines that were
13 applicable in this case, and the delays in receiving discovery
14 and the like, I was not able to actually do the necessary
15 calculations by the prefiling date. I have prepared similar
16 calculations for other states, so I can describe to you in
17 detail the process that I am recommending, but I have not had
18 the opportunity to submit to you an exhibit showing a specific
19 example or specific setup of wire centers that have those
20 homogeneous characteristics.

21 COMMISSIONER DEASON: Is it your opinion that we have
22 the necessary information in the record to do the exercise that
23 you would have done had you had the time?

24 THE WITNESS: You have most of the data you would
25 want. The only data that -- if there is data missing, and I

1 can't say exactly what you have in your record, it is certainly
2 available as public data that you could take administrative
3 notice of. There is published data by the FCC that they use
4 for the federal universal service fund process. The data that
5 feeds into their cost model that they use to determine the
6 relative cost of various states, various parts of states has
7 the data you would need as far as like the area served by each
8 wire center, so you can calculate density. It has published
9 data as to the number of lines in that wire center.

10 Certainly from what I have seen of the discovery in
11 this case there is quite a bit of discovery that tells you the
12 presence or absence of CLECs in various wire centers. The
13 basic data you need is the number of collocators in a wire
14 center, and by that I mean not just those who are operating a
15 switch for local exchange, not necessarily just serving mass
16 market, the broadest measure of collocation including IXCs.
17 That does give you some indication of the feasibility of
18 collocation in that wire center, the attractiveness of that
19 market. So that is an independent data set you can look at
20 that is completely unaffected by UNE-P and its pricing.

21 So the number of collocators, certainly the number of
22 enterprise customers, or at least a proxy for that. Again,
23 that would be publicly available from the universal service
24 data set, because that data set publishes the number of single
25 line, I believe, and multi-line business customers. It

1 certainly has the number of special access customers, which are
2 highly correlated with the enterprise class. DS-1 special
3 access, DS-3 special access is available in that data set.
4 Again, you may have additional data that your staff asked for
5 in this proceeding, and other states have been working and
6 there is often complimentary data sets that are very similar
7 that track the same basic information.

8 So, if you can get a measure on the amount of
9 collocation, the line density, and by that I mean total number
10 of lines divided by square mile served by the wire center, and
11 the presence of enterprise customers as indicated by special
12 access lines or multi-line business customers, you have a
13 pretty good indicator. You can look at that data together and
14 very quickly get a sense of whether -- you would know
15 personally if you went to a particular place and said, well,
16 this one is downtown and there is lots of businesses and lots
17 of buildings, and now just a few miles away the next one over
18 is at the edge of the Everglades and it is almost entirely
19 rural in character, some sugar farms or whatever. You can see
20 that pattern in the data very quickly and can assemble it.

21 So if you start working from each individual wire
22 center, and say are the ones next door to it, nearby of the
23 same sort of characteristics, do they belong together or not,
24 and that process can be done fairly easily. Your staff could
25 certainly do it assuming you went ahead and brought in any

1 extra data like I am describing beyond what they already have
2 available to them.

3 And ultimately, although I think it is useful to
4 perform the exercise for every single wire center, ultimately
5 the ones that matter, of course, are the ones that are in
6 dispute, the ones that BellSouth or Verizon is claiming that a
7 nonimpairment is present. If you focus in on those, you may,
8 in fact, find that say within the Tampa/St. Pete MSA there is
9 very distinct heterogeneous patterns occurring, and that
10 downtown Tampa is fundamentally different than the areas to the
11 east of Tarpon Springs or whatever, north of the bay.

12 So, you can look at it and determine which wire
13 centers belong together, so that then in turn when you look at
14 your trigger analysis, if you, in fact, conclude that, say in
15 downtown Tampa there are -- and I will just pick a number as an
16 example based on what I have seen in some other states that
17 would be typical of, say, Phoenix or Cleveland, places like
18 that, you might find 20 collocators present in the key wire
19 centers downtown, and there may be seven or eight CLECs that
20 are operating with switches in there.

21 But then in turn when you focus on how many are
22 actually serving mass market customers, it may drop to a very
23 borderline situation, maybe five, maybe four. Clearly, the
24 nonimpairment standard would be met if it is, in fact, five or
25 four, but that is a step-wise process that I think can work

1 very clearly. And then the key question is, having found
2 nonimpairment in downtown Tampa, does that, therefore, take
3 UNE-P away throughout the entire Tampa/St. Pete/Clearwater
4 area, every single wire center however far away from those
5 kinds of characteristics. I would suggest that it would not be
6 wise to reach a finding for the entire MSA based on what is
7 happening downtown, but that is the key issue.

8 COMMISSIONER DEASON: You were here this morning when
9 Mr. Ruscilli was on the stand, is that correct?

10 THE WITNESS: Yes. If not in the room, I was
11 listening in for a good part of it.

12 COMMISSIONER DEASON: Okay. He expressed his
13 understanding that CLECs place switches, but while they may be
14 placed in a central metropolitan densely populated area, that
15 they have the capability of serving much broader geographic
16 areas. Do you have any information or opinion on that?

17 THE WITNESS: Sure. Yes, that is true. It is not
18 the end of the story, but it is certainly true. And I tried to
19 indicate that in my testimony about the fact that a CLEC may
20 enter in Orlando and ultimately serve Jacksonville or Tampa
21 with that same switch. Which I think kind of suggests that
22 these MSAs, even though they are very large, clearly cannot be
23 the right answer because the scope of an individual switch is
24 not simply determined by geographic proximity.

25 What is critical is the backhaul network to get from

1 the remote location back to that switch. So, to connect a
2 Jacksonville downtown collocation to downtown Orlando may, in
3 fact, be the best way a CLEC can serve those two markets given
4 its initial entry position and the lack of customers in both
5 markets. Say, put in one switch and pay the very expensive
6 cost of the fiber system between Jacksonville and Orlando. It
7 is a multi-step entry process. They decide to enter a section
8 of the country, such as Florida, Georgia, Alabama, then they
9 decide how many switches to put in at least initially, and then
10 in turn they try to figure out what customers can I serve with
11 that switch.

12 So they may immediately be attracted to downtown
13 Orlando and they start doing that, then they look around and
14 say given the kind of customers I am appealing to, which may be
15 enterprise customers, my next best place to go is Jacksonville,
16 or Tampa given the realities of what kind of customers are
17 there and what my sales pitch is good at, what we do
18 particularly well. And it is going to be much harder for them
19 to sell Jacksonville and to make money, because they have got
20 to pay for the fiberoptic connection back up to Jacksonville.

21 But it is still a step-by-step process. They have
22 got to look at the collocation in Jacksonville, they have to
23 look at the electronic equipment in that collocation cage that
24 hooks to the end of the fiber and sends it back to Orlando.

25 The added cost, and the reason why geographic

1 proximity is certainly relevant is there is a function of that
2 distance. That fiber costs money per mile, whether they are
3 renting it via channels from somebody else, from AT&T or from
4 BellSouth, or whether they have put it in themselves, or
5 purchased the fibers from somebody.

6 However, you cut it, it is costing money to go a
7 longer distance, and that is why you don't often see a single
8 switch serve an entire region of the country because of the
9 very high cost of the fiber. But it is physically possible to
10 do it.

11 The critical thing then is in each individual wire
12 center they have to make a decision, is it cost-effective to
13 put in the collocation. Do I have techs in that area,
14 technicians who can go work on that equipment if something goes
15 wrong. Are they there to make sure a transition happens
16 smoothly.

17 If I have got a very important customer and I've got
18 to absolutely make sure they have continuous service, I have
19 got to send somebody to that wire center and make sure my
20 equipment works right, and I don't have fingerpointing between
21 me and BellSouth. So, obviously it is much harder to do that
22 in Jacksonville than it is to do it in Winter Park, but they
23 can technically do it as far away as Jacksonville if they
24 wanted to.

25

1 COMMISSIONER DEASON: So is that one of the reasons
2 why you think it is important to look at the number of
3 collocators in a wire center?

4 THE WITNESS: Yes, because it is one way to very
5 quickly detect where are the important key markets where
6 competitors are drawn to. And it is independent of this
7 dispute about whether the UNE-P rates are too low or not and
8 whether they have somehow brought in some artificial
9 competition.

10 As IXC's, including ones based out of the midwest or
11 whatever who need to terminate calls into the Jacksonville
12 market or whatever, they are putting in collocation, as well.
13 So you will get a pretty good quick measure of what are the key
14 locations in a state, where there is enterprise customers,
15 where there is a lot of activity, those are sort of the
16 critical nodes in the state. Total gross number of collocators
17 is indicative of that, and it includes both the CLECs and the
18 IXC's to the extent they differ.

19 COMMISSIONER DEASON: Thank you.

20 THE WITNESS: Thank you.

21 CHAIRMAN BAEZ: Staff, you had some questions?

22 MR. SUSAC: Yes. Thank you, Chairman. Following up
23 on Commissioner Deason's questions, that was --

24 COMMISSIONER JABER: May I ask questions before staff
25 does?

1 CHAIRMAN BAEZ: Go ahead, Commissioner. I'm sorry.

2 COMMISSIONER JABER: No problem. Dr. Johnson, hello.
3 I have got just four questions that may turn into something
4 more dependent on your response, but I want to put you on the
5 spot a little bit and ask you from the possible approaches to
6 define the geographic market that we have in the record, and
7 just to summarize, wire centers, MSAs, LATAs, the UNE rate
8 zones that BellSouth proposed we use as further divided by the
9 CEAs. Do I understand your testimony to be that out of all of
10 those if you had to pick one you would pick wire centers?

11 THE WITNESS: Yes. The MCI approach would be my
12 first choice. If I had to pick another my second choice would
13 be BellSouth's.

14 COMMISSIONER JABER: Okay. So MCI wire center and
15 then BellSouth would be your second?

16 THE WITNESS: Right. And then the rest are distant
17 thirds or fourths.

18 COMMISSIONER JABER: Okay.

19 THE WITNESS: They are much broader and have much
20 more problems.

21 COMMISSIONER JABER: To some degree would you agree
22 with me that the UNE rate zone approach does incorporate some
23 analysis of wire centers because there are a number of wire
24 centers in each rate zone, is that correct?

25 THE WITNESS: Yes, it is helpful in that regard. It

1 does tend to separate the rural wire centers from the suburban
2 and urban, but not as cleanly as could be done if you did it as
3 a separate analysis.

4 COMMISSIONER JABER: Okay. Now, for those that do
5 not recommend the wire center approach, they say it is because
6 that approach doesn't accurately reflect how competitors select
7 how they select, why they select, where they will enter the
8 market. Do you disagree with that, and if so, why?

9 THE WITNESS: I think they are only giving you a part
10 of the picture, so to that extent I disagree. The actual entry
11 process is multi-staged. This would be clear in the
12 literature, but more importantly it is clear from watching the
13 actual behavior of firms. As I said a moment ago, they would
14 first choose to enter the market in the whole. They say I am
15 going to become a telephone company in the case of a startup,
16 or I'm going to enter the local exchange business in the case
17 of an IXC. Then they decide what region of the country they
18 are going to enter, then they decide where to put a switch in
19 if they are putting in a switch. Or, in general, where to
20 start targeting and looking for customers if they haven't yet
21 made up their minds they are going to do a switch.

22 Then as they -- they can enter with UNE-P on a more
23 loose basis. They still have to make decisions which areas
24 they want to start up in, but for this critical question in
25 this case of a switch-based carrier, or a carrier deciding to

1 put in a switch to serve existing customers, either way that
2 decision to install a switch and serve customers using their
3 own switch does take place and has to take place wire center by
4 wire center, because they have to do two things. They have to
5 pay for the collocation and the backhaul equipment physically
6 located at that switch. So there is fixed costs associated
7 with each and every wire center and they have to be sure they
8 can cover those fixed costs by the revenues they think they can
9 generate in that one wire center.

10 And, secondly, they have to put together a backhaul
11 network or a method of connecting back to the switch. And when
12 doing that it is a much more complex problem, somewhat akin to
13 the problem an IXC has when trying to decide how best to serve
14 a nation. And that they could possibly put together a fiber
15 ring, which gives them added resiliency and added redundancy.
16 If so, they have got to find locations, wire centers that kind
17 of form a circle.

18 But conceptually you can visualize there is two
19 steps; they have to pay for the wire center's specific fixed
20 costs, and they have to pay for the distance sensitive costs
21 that involve connecting those remote locations where the
22 customers and the loops are back to their switch.

23 COMMISSIONER JABER: Now, maybe I'm naive, but at
24 some point I would also consider how many product offerings I
25 could sell to one customer.

1 THE WITNESS: Absolutely. That is certainly --

2 COMMISSIONER JABER: I'm sorry, go ahead.

3 THE WITNESS: No, I agree with you. That is
4 certainly a factor.

5 COMMISSIONER JABER: So, now what part of your
6 analysis would take that into account? Is it the wire center
7 approach, is it all of these approaches?

8 THE WITNESS: It is very much behind the scenes what
9 is going on. In terms of a self-provisioning trigger analysis,
10 the place where I would suggest that is most important is at
11 the end of the process when you have the data in front of you
12 and somebody is urging you, your staff recommendation coming to
13 you in agenda conference, whatever the stage is when you are
14 sitting there about to make the decision that there is a lack
15 of impairment based on the activities of say, three or four
16 CLECs. I would then ask the question, well, let's talk about
17 those three or four CLECs. Are they serving residential
18 customers? Are any of them serving residential customers? If
19 so, how many? Is it one or two customers, is it hundreds?
20 What is going on?

21 To a lesser degree, I would also have some concern
22 are they serving the full array of business customers. Are
23 they highly specialized only serving those business customers
24 that have data needs and happen to have a small number of
25 lines. Is there any special circumstances here that might slow

1 me down. Not necessarily to flinch from the finding of
2 nonimpairment, because, in fact, you may want to find
3 nonimpairment.

4 It may be clear you are supposed to under the TRO,
5 but just this question of whether that nonimpairment is
6 indicative of the entire broad market, all types of products,
7 all types of customers. Those who only use a few features,
8 those who use a lot. Or is it only indicative of a lack of
9 impairment for some specialized niche market, such as small
10 businesses that happen to need a high level of data intensity
11 or have specialized needs.

12 If there is any suggestion or evidence at that point
13 that the data you are seeing these triggering carriers are, in
14 fact, focusing on a small subset of the geographic market, then
15 that is the stage where I think the footnote that I cited to
16 becomes important, and an opportunity to still have this
17 controlled experiment of removing UNE-P, but removing it in a
18 more cautious manner.

19 COMMISSIONER JABER: Okay. Then my final question
20 transitions from your response, which is if I should take into
21 account how many product offerings and what the customers are
22 really -- whether it is one or 100 are really acquiring from
23 these competitors, then how does the FCC universal service data
24 help us determine that information? Because as I understand
25 the universal service information and what it provides to us in

1 determining costs, it doesn't include all providers or give us
2 an accurate depiction on different offerings.

3 THE WITNESS: All of that is true. It is a device I
4 was suggesting for doing two things. Let me back up. I was
5 not in any way suggesting relying on the universal service data
6 set in lieu of the discovery that is present in the proceeding.
7 I was merely suggesting as a readily available administrative
8 substitute, something you could take administrative notice of
9 and use even if there turned out to be some gaps in the
10 discovery. And I'm not saying there are gaps. There may not
11 be any. Strictly a way of supplementing it.

12 That I am confident that standardized data is readily
13 available as to density, as to the presence of special access
14 activity, enterprise activity. But, no, that data in and of
15 itself does not tell you the types of products being sold, and
16 the only way you will really know that is if through the course
17 of discovery and the evidence that has been brought forward
18 some parties have pointed out subtleties.

19 If, for example, FDN has a specialized product mix
20 that you could see, for example, in your tariff filings that
21 are on record with you, and say they are a unique case. If
22 they are. I am not suggesting they are, but that is the
23 question. Are they a unique case, or are they, in fact, a
24 typical CLEC. And if they are a typical CLEC, the critical
25 question under the FCC TRO is not whether they are typical in

1 and of themselves, but are there any others like them. Is
2 there a second or third carrier.

3 Because what the FCC did is basically said
4 conceptually if a carrier can make a go of it using their own
5 switch to serve a correctly defined market, then that is
6 indicative that impairment is not present. However, they
7 recognize that a single carrier might be an anomaly. So they
8 set this criteria of three carriers. And that is the key
9 point, are all three of the carriers you are relying upon for
10 the self-provisioning trigger actually indicative of what is
11 possible for a carrier that wants to serve the market and
12 chooses to use a switch. That it is economically feasible for
13 them to do so, and that there are thus indications that
14 impairment does not exist in that particular market.

15 So, it is a long way of saying this product question
16 is a very interesting one. I am not certain the degree to
17 which the discovery allows you to separate that out, but
18 certainly your tariffs that are on file would give you further
19 indications as to whether particular carriers that are
20 allegedly triggering carriers have some special niche market
21 they are serving, or are they serving residential and business
22 customers generally.

23 COMMISSIONER JABER: Okay. A final question. I'm
24 going to ask you to speculate, because I know you have a lot of
25 experience in this area, and I know you have testified in a

1 number of proceedings. And it truly is a question where I am
2 asking you to speculate, so I will take that into account. But
3 if, as AARP concedes, the TRO seems clear that there is some
4 part of this that we have to recognize from a mandatory
5 standpoint there are areas where no impairment exists and,
6 therefore, switching has to come off the UNE list for those
7 areas, what do you think will happen in terms of a competitive
8 response? How will the competitors react?

9 THE WITNESS: First, whatever I think -- and I will
10 give you my opinion in a minute -- is not the only question.
11 You also have to think about the risks involved that anyone's
12 opinion, including mine, may be off the mark. That we are
13 trying to predict what will happen, are we right or not.

14 That is why I have used this phrase controlled
15 experiment, because I think that is one way to look at this
16 entire process is there is going to be a controlled experiment.
17 Some states will be very careful in deciding where
18 nonimpairment exists. They will remove UNE-P in those
19 particular markets and over the next 27 to 36 months we will
20 see the behavior of the CLECs.

21 And the critical issue in my mind is let's have a
22 controlled experiment, not just a wide open let's just see what
23 happens and remove UNE-P throughout virtually the entire
24 market. Removing it from every MSA that has any substantial
25 number of customers. If you remove it from 70 or 80 percent of

1 the market at once, to me that is not a controlled experiment,
2 that is a leap of faith, shall we say.

3 As to what I think will happen, I think what will
4 happen is some of the CLECs who are already succeeding in the
5 small business market and are succeeding in the enterprise part
6 of that small business market when no longer able to use UNE-P
7 to serve the smaller customers, will try to use their existing
8 switch to expand it. Whether it is an MCI, I can't say for
9 sure, but it would not surprise me that MCI, if forced to do
10 so, rather than lose the customers entirely and lose the long
11 distance revenues and every other part of the revenues they are
12 getting from those one and two line business customers, will
13 choose to stay in the market and try to make a go of it by
14 expanding the use of their switch.

15 It may squeeze their margins, they may not be able to
16 offer quite as attractive prices, but I think some carriers
17 will stick it out. I do believe other carriers will simply
18 abandon the business entirely or withdraw entirely from those
19 markets where they can no longer use UNE-P. They simply don't
20 have the capital to install the switches they need and they may
21 not have the technical expertise to do the full-blown
22 facilities-based business model. They will withdraw back to
23 rural areas, they will withdraw back to places where they can
24 feel pretty confident that the business model they have been
25 succeeding at will continue to be in existence for awhile.

1 So I think you will probably have a mixture of
2 reactions. What is the hardest to predict is whether there
3 will be any competitive alternatives for residential markets.
4 Or if there is any, how significant those will be. In other
5 words, will an MCI just target the extreme high end of the
6 residential market, the folks who are willing to pay a flat
7 rate of \$59 a month, which is maybe double what they are paying
8 from BellSouth, but to get a lot thrown in in the package. If
9 you like that stuff, if you like caller ID and call waiting and
10 all those things, they may try to serve those customers.

11 But the real question is will any of the carriers if
12 they are forced out of the UNE-P mode of operation attempt to
13 serve the smaller customers, those on fixed incomes, those who
14 simply don't value all those bells and whistles. And that is
15 much harder to predict, because I can't say for sure none of
16 them will try it, because once you are in a business and you
17 are forced to do certain things, certain costs become sunk and
18 then you look at the next decision, and you say, well, you
19 know, if I can spread my marketing costs over another group,
20 you know, there are some benefits here.

21 So I can't say for sure there will never be any
22 residential customers getting competitive alternatives in the
23 controlled experiment locations, but certainly there is a
24 serious risk that the competitive alternatives will go away or
25 be greatly reduced and diminished.

1 COMMISSIONER JABER: Thank you, Dr. Johnson. And,
2 Mr. Chairman, thank you.

3 CHAIRMAN BAEZ: Thank you, Commissioner.

4 COMMISSIONER DEASON: I have another question,
5 please.

6 CHAIRMAN BAEZ: Commissioner Deason.

7 COMMISSIONER DEASON: This question kind of relates
8 to the last question and answer that Commissioner Jaber asked,
9 but it also relates back to one of your core principles, and
10 that being -- and forgive me, I just jotted it down, I may not
11 have it correctly. But, basically, one of your core principles
12 is that we, as decision-makers, we need to look at the degree
13 to which switches being used for residential service versus
14 small business when we are making our ultimate decision. Am I
15 paraphrasing that correctly?

16 THE WITNESS: Yes, I think at the last stages of the
17 process in particular, once you have got a pretty good handle
18 on the data, that is something you do want to look at.

19 COMMISSIONER DEASON: Okay. If we reach that stage
20 and we are asking that question, how do we get a handle on
21 whether the degree of residential versus small business in that
22 mass market is simply due to the fact that small business
23 usually has more of a higher profit margin, more of an emphasis
24 for those customers to be served and is not necessarily -- and
25 the fact that UNE-P is available.

1 That is a more cost-effective alternative to provide
2 service to residential customers and it is not necessarily an
3 indication of whether that particular carrier could or could
4 not cost-effectively serve residential customers out of their
5 own switch, they just choose to use UNE-P because it is
6 available. And since is available, that is their choice. And
7 that if it were to become unavailable, it would still be
8 cost-effective for them to utilize their switch and to serve
9 residential customers. Do you have any guidance in that
10 particular area?

11 THE WITNESS: I can try. That is a very subtle
12 question, and you have gone to the heart of what the federal
13 judiciary has asked the FCC to do, and what the FCC has asked
14 you to do. And I'm sure you understand that. That it is sort
15 of a -- it is a difficult mathematical problem that is in that
16 sort of in that part of the temporarily knowns are themselves
17 variables. So the UNE-P rates are potentially affecting some
18 of the data we observe.

19 One way to think about it, however, is that a carrier
20 that -- many carriers throughout the nation are using their own
21 switch to serve the enterprise market, so we know that in and
22 of itself it is not simply a question that TELRIC somehow is
23 too low, and that every regulator is getting it wrong, and that
24 the FCC got it wrong. That can't be the answer, because
25 carriers are putting in switches and they do serve using their

1 own switch.

2 But we know that they primarily target enterprise
3 customers. One possible reason for that is with your own
4 switch you can differentiate your product on the basis of
5 quality and features and functions that are not readily
6 available from the incumbent. You have a better story to tell,
7 and it may simply be that the enterprise customers are more
8 willing to listen to that story at this time in the evolution
9 of the market. That residential customers are still basically
10 buying plain old telephone service, and they are not as
11 impressed by statements like we will give you higher
12 reliability, or we will give you clearer sound, or we will give
13 a better voicemail function, or whatever.

14 So that is one thing you can look at. But then you
15 in turn look at the enterprise customers and enterprise
16 carriers, those who are focussing on enterprise customers. At
17 that point when they then make a decision should I also try to
18 sell small business or residential customers, from their point
19 of view in most cases virtually all of the switching cost is a
20 sunk cost that is essentially zero. So any sort of a
21 TELRIC-based calculation is more expensive than the next cost
22 they are facing in deciding while I am serving this wire center
23 and while I am serving the enterprise customers in that wire
24 center, can I also afford to serve business, very small
25 business, or residential customers.

1 So that is the critical issue, and if they are
2 serving some of those customers and serving them in a
3 significant way, then there isn't an actual impairment or
4 impediment that is preventing them from doing it. But if you
5 are seeing a pretty uniform pattern that even though they have
6 the switch installed, and even though I am confident they are
7 going to have excess capacity, any plausible CLEC at this stage
8 in their growth pattern will still have plenty of room on their
9 switch.

10 If they are not venturing out in that market it is
11 due to something. It may be as simple as the lack of the
12 proper batch hot cut process, there is no feasible way for them
13 to crank over 50 and 60 lines at a time from all these
14 different customers and all these different locations. And
15 absent that, it just isn't practical. They know that those
16 sort of impediments are making it too hard for them to sell the
17 service.

18 Whatever the reason, I think that subtlety of looking
19 at how the carriers themselves are behaving, if they put in the
20 switch, they are serving the enterprise customers, are they
21 venturing out and serving smaller business customers, are they
22 venturing out and serving residential customers with that
23 switch knowing that a lot of the costs, virtually all the costs
24 are sunk costs for them.

25 COMMISSIONER DEASON: Do you have any particular

1 recommendation as to what percentage we should look at? You
2 know, 1 percent, 5 percent, 10 percent, you know, enterprise
3 versus mass market, or is it just something we just need to
4 develop a feel for, or do you have any experience in that area?

5 THE WITNESS: I do think you are going to have to
6 look at it on a case-by-case basis. I do know for certain
7 purposes a number may be helpful. I think it is unfortunate
8 that BellSouth didn't choose to do what SBC has chosen to do at
9 least in Ohio, and I think in some other states. Rather than
10 quibble over this problem of what if there is one residential
11 line, or one small business line that is sort of this
12 exception, does that count as a trigger?

13 What SBC has done is said six or under, we are going
14 to assume that is noise in the data, in essence. That we
15 don't, you know, really figure out why there is five or four
16 lines, but if a particular carrier just has five, six, three
17 lines, we will treat them as if they have none. And I think
18 that was a conservative approach, and a wise approach, because
19 chances are if you investigate in detail it will turn out to be
20 a president or some important person on an enterprise customer,
21 you know, they may be losing money on that line, but they are
22 serving it to make the enterprise customer happy.

23 But once you get above that number, then you start
24 getting in this gray zone of, well, maybe they are, in fact,
25 willing to serve and able to serve and are choosing to serve

1 small business customers, they just haven't been as successful
2 at it. So once you get above a number like six, I think you
3 have to take it case-by-case and look at it carefully, and look
4 at the circumstances of the degree to which they are, in fact,
5 serving.

6 The presence of, say, 35 small business lines in a
7 single wire center by a single carrier is much more significant
8 if they only have five enterprise customers in that wire
9 center. For that carrier, that is a significant effort. For
10 another carrier, you know, an MCI maybe, that has tremendous
11 volume and has large numbers of enterprise customers, if they
12 happen to be serving 14 small business customers I would say
13 that is much more questionable whether that is any indication
14 of their ability to do it on a routine basis.

15 COMMISSIONER DEASON: Thank you.

16 CHAIRMAN BAEZ: Mr. Susac.

17 MR. SUSAC: Thank you, Chairman.

18 CROSS EXAMINATION

19 BY MR. SUSAC:

20 Q Digressing back a little bit, Dr. Johnson, to what
21 Commissioner Deason originally asked, and that is when you
22 aggregate, and when you begin to look at the market, the wire
23 center, and you aggregate these wire centers to a size that is
24 sufficient to have economies of scope and scale, our concern is
25 where do you stop. At how many wire centers, where do you glue

1 them together, and where do you begin. If we were to give
2 you -- if we were to ask you for a late-filed exhibit, is this
3 something that you possibly do within three weeks?

4 A Yes, I could. And you would just need to tell me
5 whether you want it for a particular MSA or what area you would
6 like me to do it for. But, yes, I could do that.

7 MR. SUSAC: Give me one second, please. I'm going to
8 shift the burden back to you, something that represents your
9 methodology and your analysis. And I think it is only fair if
10 we give him to approximately March 18th. Briefs are due by
11 April 6th, this gives sufficient time for parties to respond to
12 this information if it is, in fact, accepted.

13 CHAIRMAN BAEZ: All right. Can you restate what the
14 late-filed exhibit will contain?

15 MR. SUSAC: Sure. Why don't we label it universal
16 data service needed for this proceeding.

17 THE WITNESS: Before we close this, I want to be sure
18 I have a clear understanding of what is being asked. What I
19 understand is an assembly of the data illustrating the process
20 that I have been describing of defining small groups of wire
21 centers with homogeneous characteristics that would
22 appropriately be considered individual markets within one or
23 more MSAs.

24 MR. SUSAC: Correct.

25 THE WITNESS: Okay.

1 CHAIRMAN BAEZ: Then we will mark that as Exhibit
2 104.

3 (Late-filed Exhibit 104 marked for identification.)

4 CHAIRMAN BAEZ: And that date is March 18th, correct?

5 MR. SUSAC: That is correct, Chairman.

6 CHAIRMAN BAEZ: Okay. Dr. Johnson, are you okay with
7 the date?

8 THE WITNESS: That's fine, yes.

9 CHAIRMAN BAEZ: Okay. Thank you.

10 MR. SUSAC: And I just have two more questions.

11 BY MR. SUSAC:

12 Q Dr. Johnson, are you specifically asking this
13 Commission to split the market between residential and business
14 customers?

15 A Not on a statewide universal basis, but I am asking
16 you to keep that option open. When you finish the rest of the
17 process, you have defined the markets, you can see what is
18 happening, if you find instances of a market where the trigger
19 is pulled based purely on small business activity, and there is
20 no significant residential activity present, then I would
21 certainly ask you to consider using the authority I believe is
22 there present as indicated by the footnote I cited to pull out
23 the residential. Have the controlled experiment by removing
24 UNE-P for business customers in that market while retaining
25 UNE-P for awhile longer for residential customers in that

1 market.

2 Q Is there a technological difference between
3 residential service and business service? I mean, how would we
4 make that determination?

5 A There is a difference in the sense that you could
6 declare that UNE-P, or UNE switching, which is the essence of
7 UNE-P, is no longer available for use by any customer who is a
8 business. That using the classic traditional definitions that
9 are used by BellSouth or other carriers to charge business
10 local exchange rates rather than residential local exchange
11 rates.

12 Since it is a switch service, since there will be a
13 phone number associated with it, it would be very easy for
14 BellSouth or Verizon to police that and to refuse to provide
15 UNE-P to a customer who, in fact, is using the line as a
16 business.

17 Q Well, is there such a thing as a residential wire or
18 a business wire?

19 A Not at all. And, again, we are talking about
20 distinguishing the manner in which CLECs market to customers,
21 the manner in which customers purchase the service. It is what
22 I was referring to earlier as a demand-based subtlety or
23 distinction. I'm not suggesting there is major technical
24 differences.

25 There are some differences. Business customers tend

1 to demand a higher level of quality, greater reliability, they
2 are less willing to put up with an uncoordinated hot cut where
3 they might lose service for a few hours. A business facing
4 that might just absolutely refuse to even think about the idea
5 of switching. A residence, if you wave enough of a gift
6 certificate in front of them, or, you know, free miles or
7 something, they might take their chances. So there is some
8 differences, but I'm certainly not suggesting it is a
9 difference in the wire.

10 Q Let me jump ahead. Are the unbundling rules specific
11 to loop type?

12 A No, not generally. I mean, there are some subtleties
13 you might have. In some states you will have four wire rates
14 that are subtly different than paying for two two-wire
15 circuits, but, generally, no.

16 Q Okay. So the obligations and limitations expressed
17 in the rules do not vary based on the customer being served, is
18 that correct?

19 A That is correct. In general, the UNE rate process,
20 the costing process, and the rate process treat businesses and
21 residence customers exactly the same.

22 Q Dr. Johnson, do you have the Triennial Review in
23 front of you?

24 A I have some excerpts, but not the entire document.

25 Q Okay. Subject to check, Paragraph 210 states, "Thus,

1 while we adopt loop unbundling rules specific to each loop
2 type, our unbundling obligations and limitations for such loops
3 do not vary based on the customer being served."

4 If you turn to Page 192 of the TRO, the second
5 sentence in Note 935 states, "We reiterate that we do not
6 tailor our rules to restrict or limit unbundling based on the
7 size or class of the customer served."

8 And what my question is geared at, these obligations
9 and limitations expressed in the rules that I just read do not
10 vary based on the customer being served, is that correct?

11 A Yes. That is the point I made previously. In
12 general, the UNE rate process and the unbundling process does
13 not make any distinction between business and residential
14 customers.

15 MR. SUSAC: Okay. There is no further questions,
16 Chairman.

17 CHAIRMAN BAEZ: Thank you, Mr. Susac. Mr. Beck, did
18 you have any redirect?

19 MR. BECK: No, I don't. I would move Exhibit 103.

20 CHAIRMAN BAEZ: Without objection, show Exhibit 103
21 moved into the record. And I'm showing a late-filed by March
22 18th.

23 (Exhibit Number 103 admitted into the record.)

24 MR. BECK: All right. At this point I think we can
25 break until 1:00 o'clock, and then we will get started on the

1 impairment case. All right. We are in recess. Thank you.

2 (Lunch recess.)

3 (Transcript continues in sequence with Volume 18.)

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1 STATE OF FLORIDA)

2 : CERTIFICATE OF REPORTER

3 COUNTY OF LEON)

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I, JANE FAUROT, RPR, Chief, Office of Hearing Reporter Services, FPSC Division of Commission Clerk and Administrative Services, do hereby certify that the foregoing proceeding was heard at the time and place herein stated.

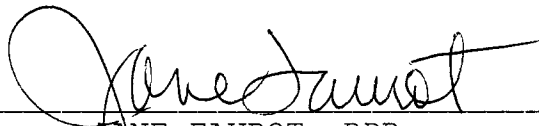
IT IS FURTHER CERTIFIED that I stenographically reported the said proceedings; that the same has been transcribed under my direct supervision; and that this transcript constitutes a true transcription of my notes of said proceedings.

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

DATED THIS 1st day of March, 2004.

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