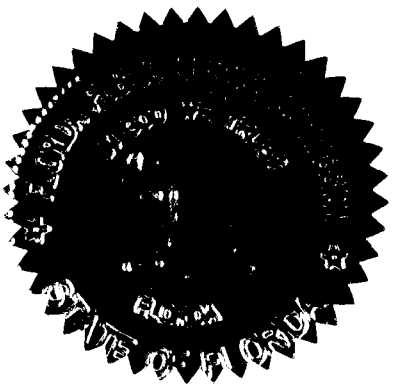
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

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 25

Pages 3645 through 3737

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.

PLACE:	Betty Easley Conference Center Room 148 4075 Esplanade Way Tallahassee, Florida
REPORTED BY:	TRICIA DeMARTE, RPR Official FPSC Reporter (850) 413-6736
APPEARANCES:	(As heretofore noted.)

I N D E X

WITNESSES

P R O C E E D I N G S

(Transcript follows in sequence from Volume 24.)

MR. MAGNESS: If you're not going to rely on the CLECs's statements, look at how loops are provisioned by the ILEC. Go back again to analog, digital. Now, Verizon did that. Verizon gave us a fairly straightforward analysis, the line count study Mr. Fulp talked about, that took a look at where they served DS0s, where they served DS1s, they being the CLECs off their own switches. And I think as you could tell from the discussions with Mr. Fulp yesterday, my quarrel, my client's quarrel, more properly, with Verizon's approach wasn't methodological. We differ about how you read the TRO, and I'll talk to you about that in a minute. But if you're going to get at this essential distinction, which is at the heart of the TRO about analog versus digital, mass market versus enterprise, you have got to understand that data set.

Now, BellSouth, we asked for that data set. We asked for it over a period of months so we could see what the trends were. We asked what BellSouth relied on for its triggers. We got back 3,079 pages of data. We deposed a trigger witness. We learned that within that 3,079 pages there was one file that -- from 1,986 to 2,012 which was the summary of everything we really need to know, but it wasn't a DS0, DS1 breakout. We had to deposed the trigger witness twice. I didn't want to do that the other night during the hearing, but the new data was

coming in. I know Ms. Tipton said it's not new data. Well, of course it's not new data. It's all BellSouth's data. It's all sitting in their database. It's their loop data. They sell the loops to the CLECs. Of course it's not new data. But that's just the kind of game playing with the words that's keeping this Commission from getting the data it needs to solve this problem.

They asked ambiguous questions in their discovery which did not necessarily elicit DS0 or DS1 as you saw in the request to Sprint, as you saw in the DS0/VGE request. But I don't like to get down in the weeds on discovery, but it turns out, you know, the DS1 screen that was supposedly applied to all of their trigger evidence was applied up at the database in Atlanta, I guess. I mean, maybe I'm too dumb to read this stuff, but Verizon's study didn't look like that. When we asked Verizon for the data supporting their trigger analysis, we got, like, a spreadsheet.

BellSouth is making what should be easy about this case hard. It doesn't need to be. And they want to tell you that the actual competition inquiry is so easy you could do it in your sleep. In fact, you don't even need to do it because all you have to look at is the same stuff the FCC looked at. That doesn't make any sense.

Now I'm going to -- Mr. Gillan is going to talk to you about the triggers, but I want to talk to you -- I want to

take the same liberty that -- it's not liberty, but whatever it is, that Mr. Lackey did. And I'm going to tell you I'm a lawyer. I'm going to talk to you about the law. And I've got -- I handed you out the summary of the TRO trigger provisions that I gave you last night that we entered in. There's a paragraph though that's not referenced there that I want to read a sentence to you. Paragraph 189, "To ensure that the states implement their delegated authority in the same carefully targeted manner as our federal determinations, we set forth in this order federal guidelines to be applied by the states in the execution of their authority pursuant to federal law." The same carefully targeted manner as our federal determinations. So when you see guidance from the FCC about what did not convince them that there was competition in the mass market, it ought to give you a pretty good idea of what should not convince you or what should convince you as you look at the evidence in Florida.

And we talk about the trigger analysis. I have Mr. Gillan's testimony. We have six trigger criteria and I'm going to walk through them quickly and show you where they are in the order because they have been called embellishments, they have been called made up.

If you could flip into the summary of the TRO trigger provisions. I give you the rule. Here's the rule. Of course the rule applies, but look at the next paragraph. In their

testimony, BellSouth's and Verizon's witnesses said you don't need to look at anything but the rule. This is ludicrous. The FCC issues orders and rules. They adopt both. They're both applicable. They both have to be followed. You can be sued if you don't follow one or the other. And, you know, when it came time for the lawyers to stand up and make that argument, you noticed they shifted into the order. I don't think they could say it with a straight face. So of course you look at the order. It shouldn't even be an issue.

Now, look at Paragraph 499. Well, actually, let me do this a different way. Since the problem was with Mr. Gillan's criteria -- they're not Mr. Gillan's criteria, they're criteria from this order -- let me go through them in order.

Number one, the self-provisioning trigger candidate switches must not be enterprise switches. I direct you to Page 13 and then on to Page 15. If you look at Page 15, there's two places in the order where the FCC could not make it clearer that you are not to include enterprise switches in the mass market trigger analysis. I don't want to waste a lot more time with them right now because I talked to Mr. Fulp about them. I don't know what else the FCC could have said more than they did in Footnote 1354. "The dissents' assertion that enterprise switches should be considered in our mass market triggers ignores these substantial differences between the

switches serving the different markets." Golly. What do they have to do to get their point across?

Number two, the self-provisioning trigger candidate must be actively providing voice service to mass market customers in the designated market, including residential customers, and must be likely to continue to do so. And for that, I direct you to Paragraphs 499, which is up towards the front of the package, and I'll just give you the other cite, 499 and likely to continue, you're going to find at Paragraph 500, which is on Page 13. And again, Paragraph 500, the key consideration to be examined by state commissions is whether the providers are currently offering and able to provide service and are likely to continue to do so.

Number three, the self-provisioning trigger candidate should be relying on ILEC analog loops to connect the customer to its switch. And here, the FCC has given the state commissions discretion. When they talk about intermodal carriers -- and I've reprinted the relevant sections at Page 3 of this document, and I'm sorry to keep flipping around, but it's better than flipping through the whole TRO. Page 3 where the Commission says in Paragraph 499, Footnote 1549, "In deciding whether to include intermodal alternatives for purposes of these triggers, states should consider to what extent services provided over these intermodal alternatives are comparable in cost, quality, and maturity to incumbent LEC

services." In considering whether to include, it is not mandatory, you have to exercise your discretion.

Now, how are you going to go about exercising that discretion? Does the FCC give you any clue? Funny, it's in the next sentence. They considered CMRS or wireless. They decided wireless wasn't there yet. What did they look at when they decided wireless wasn't there yet? For example, we note that CMRS does not yet equal traditional incumbent LEC services in its quality, its ability to handle data traffic, its ubiquity in its ability to provide broadband services to the mass market.

Now, this point raises an important fundamental point that's key to this proceeding. We are not here to tell you, you have to include intermodal, you can include intermodal. You have an exercise of discretion, and our case in the application of these criteria are trying to assist you to come up with a way to flesh out what you have been left by the FCC.

And as other paragraphs in this order make clear, it's different to think about an intermodal alternative because what does that say about your ability to access an ILEC loop? A cable company doesn't tell you much about that because they don't have to do hot cuts. They've got their own loops.

Criteria four, if the trigger candidate provides an intermodal service, its service must be comparable to the ILEC service in cost, quality, and maturity. Same area of the

order.

Five, the self-providing trigger candidate may not be affiliated with the ILEC or other self-provisioning candidates. And number six -- and that one I -- now, if Ed Whittaker (phonetic) is right, and he's staying out of BellSouth's territory, that may be about as close as an affiliate relationship as we need, but I'm not making a legal argument than one exists.

Number six, the existence of the self-provisioning trigger candidate should be evidence of sustainable and broadscale mass market competitive alternatives in the designated market. And there are a number of paragraphs and Mr. Gillan is going to talk to you about them that are guidance to state commissions as to what the FCC looked at when it tried to execute its duties and what it would expect you to look at when you execute your duties. There's a whole litany of them. I don't want to go into them all now because I want to give Mr. Gillan a chance to talk.

But suffice it to say, those are the six trigger criteria. They're all in the order. They're all directly from the order. They all need to be considered because, you know, you do need to count to three, but you need to count to three based on what the FCC told you to look at to count. And, for example, one more time about how we're trying to help you exercise the discretion here, on enterprise switch versus mass

market switch, I think it's unfortunate the FCC did not give the states a crystal clear definition of which is which.

But as, Commissioner Deason, you were struggling with with Dr. Johnson this morning, how do you decided? You have to have a reasonable metric because one thing the TRO does not want you to do, I don't think the FCC wanted you to do, is make an economically irrational decision. Now, to say that a switch that serves one mass market line, I'll even go up as high as five, and the rest is enterprise, to call that a mass market switch because it doesn't exclusively serve enterprise ignores the marketplace reality, and I'd say just the opposite. If you're serving 99 percent mass market and you've got one enterprise customer, that's going to count. That's a mass market switch for that criteria.

So the predominate use type test we're talking about, it's not that we're saying, that's in the TRO and you've got to apply it. No, we're not going to lie to you, but we're going to try and figure out a way that makes sense to apply this order and to apply an order that recognizes that, you know, deep down, the real world and the distinction between analog and digital, mass market and enterprise really exists. And if you ignore it, you ignore the peril of Florida consumers.

Now I'm going to pass the baton to Mr. Gillan.

WITNESS GILLAN: Good afternoon. By my count, I have a little under a half hour left. We will stay on schedule to

make sure we come in in our time frame. The presentation that I have basically has three components to it.

The first component is to summarize what the competitive landscape looks like in Florida today. The reason for that is really quite simple. The principle focus of my testimony is on this trigger test that the FCC asks you to undertake that's fundamentally an actual competition test. And in order conduct such a test, I think it's important for you to understand the level and scope of competition that's occurring out there today using the two entry strategies at issue in this proceeding, UNE-P and UNE-L, to get a sense of what one is able to do that the other is not.

The second is to talk to you about an anomaly, if you will, in the TRO. As Mr. Magness explained, the TRO recognizes fundamentally that the world consists of two different spheres of telecommunications services today, the digital world and the analog world. Basically those two spheres are named after the principal type of customer you can find in them. Digital world, enterprise; analog world, mass market.

Normally the customer gets to choose which world they belong in. If you want to be a digital customer, you buy a digital service, you become part of the enterprise market. If you want a regular POTs service, you buy analog services, you remain part of the analog service, the analog world. The TRO, however, asks you as the regulator to set one rule that will

decide for some customers which world they belong in, not based on the choices they made, but on a rule that you're going to implement that's going to cause you to reach into the analog market, take a group of customers, and pour them over into the enterprise market based on your decision, based on guidance from the FCC that they don't belong in the world that they chose to live in, but they're supposed to be getting service some other way. And we'll talk about that. Ironically, the FCCA finds itself in agreement with two out of three ILECs in this proceeding on that issue, and I assure you, you will never again see the FCCA in agreement with two out of three ILECs.

Finally, I'm going to go through and apply -- look at these trigger companies that both BellSouth and Verizon have claimed are evidence for you that there is no impairment remaining in the mass market and take you through those trigger companies and explain why those companies do not count for the purpose that they are being named.

COMMISSIONER DAVIDSON: Which two? I have to know now. You're holding us in suspense.

WITNESS GILLAN: The two of the three ILECs? That would be Verizon and Sprint. Unfortunately, BellSouth just can't come around yet, but we're working on them.

To give you some scale, this docket is really split into two sets of issues, the trigger and then the potential deployment. Because of the amount of testimony and time you're

going to spend with each, you could easily conclude that the potential deployment is far more important to what happens to the Florida consumers than the trigger analysis, but I think if you look at this slide, it will bring home exactly what's at stake here.

BellSouth is basically proposing to trigger out areas in a state that represent 75 percent of the access lines in the state of Florida. When they add those additional markets that they are using their potential deployment model to claim that CLECs should be competing there but just aren't, it brings that up to a little over 80 percent. So the lion's share of the issue in this proceeding is going to be decided by whether or not these actual competition triggers are being satisfied.

If you look at Florida using the most recent publicly available FCC data, this gives you a sense of what is going on in terms of the entry strategies in the state. This is the first half of last year. As you can see, basically the growing entry strategy, the strategy that is bringing the most choice to the most users in the state is UNE-P. Adding in the first half of last year about 115 lines or, said differently, over 115,000 Florida residential and business customers that today still belong in that analog POTs market, because that's what they want, were able to take advantage of competitive choice because of the availability of switching.

If you look at how that matches up around the state

and compare it to UNE-L, and we have statistics from the discovery in this proceeding for the most recent six-month period, what is clear is that UNE-P is bringing that competitive choice not to a few places in Florida but pretty consistently throughout the entire state while UNE-L simply does not have the capacity to bring that kind of competitive benefit.

In addition, you can look at that same set of data to look at how is this splitting out in terms of competitive benefit to residential customers and those analog business customers that still are the backbone of Florida's economy. You may not realize this, but actually, I think Florida is ranked number one in the county in terms of the number of small businesses in this state. And as you see by this slide that statewide it's about the same. This is an entry strategy that is bringing benefits to both market segments, residence and business.

Now, this slide takes a little bit of explanation, but I think it's well worth it. It plots out for each individual BellSouth wire center the shared gain by UNE-P and UNE-L over the last six months where the wire centers are ranked going from left to right, the largest, densest urban wire centers on the left, going all the way to the far right which represents the smallest wire centers in the state served by BellSouth. On the top is the shared gain achieved by UNE-P.

In other words, that's the percentage of the customers in those wire centers that took advantage of the opportunity to gain from a competitive choice in that April to September time frame, contrasting it to the same options being exercised by consumers using UNE-L as a strategy. In some sense, this whole debate boils down to this slide with Bellsouth asking you to look at the bottom and say, that's enough, we don't need more than that, we can get rid of the competition in the slide above.

In addition, to dispel a myth, frequently this gets characterized as though it were a battle between AT&T and MCI and the incumbent LECs. Nothing could be further from the truth. This is the division of UNE-P lines served by competitive entrants in the state of Florida with all three large IXCs, now CLECs, AT&T, MCI, and Sprint in the yellow, but the new CLECs, the new innovators such as Z-Tel or Birch or ITC^DeltaCom and so forth and so on representing, and Supra, representing the much larger area. This is a lot about removing barriers to entry and getting new service providers and new service choices.

All right. Quickly on this mass market, enterprise market distinction. Importantly, it's not based on a customer designation. It's really about what type of service does the customer want. Does the customer want a digital service or an analog service? As I mentioned at the outset, though, the FCC

has given you the responsibility, if the ILEC asks you to take it, to set an artificial cap on how big a customer can be and still be in the mass market.

Now, ironically, the FCCA in its first agreement with one of the two ILECs is we agree with Verizon. Verizon has taken the position here that the regulators should not decide whether a customer should be an analog or a digital customer; that if a customer wants analog service whether they have 5 lines, 10 lines, 15 lines, 30 lines, it doesn't matter. If the customer wants an analog service, then they should be considered part of the mass market and should be counted as part of the analog mass market. However, the FCC cannot, I don't believe, read the TRO to force an ILEC to be so generous in its interpretation; that the ILEC may insist that the Commission set a cutoff at the point where it makes economic sense for a customer with enough voice lines to be served by a DS1 loop. I think importantly the FCC direction to you is to set that point using a formula and identifying where does it become economically reasonable for a multiline customer to be served by a DS1. There is no default value of three or four lines in the TRO. There's a requirement that you set this value based on significant evidence, and that significant evidence is before you in the testimony of Sprint witness Dickerson.

It's a very simple formula. It's a very simple

calculation. It simply recognizes that a DS1 is a fixed cost per month, but as you buy additional voice lines, your cost of those lines goes up for each additional line until you hit the point at which the DS1 is less expensive than continuing to buy analog voice lines as UNEs. Now, that calculation for the state of Florida is 12 lines.

So what we have before you is a very straightforward division of the world between the mass market, which in BellSouth's territory would be analog customers up to where they have 12 lines, the enterprise market is comprised of all those customers for whatever reason bought a DS1 and actually made the choice to become a digital customer because; plus these analog customers that by regulatory rule are being moved.

Now, part of the issue here at some point is going to be what does the data show. And there's an important unanimous agreement, I think, in this proceeding that the enterprise market does not count in terms of doing a trigger analysis or -- well, in terms of doing a trigger analysis. Now, we're going to disagree with BellSouth and Verizon as to at what point you call a carrier that's serving the enterprise market a mass market switch. No doubt about it. Big controversy. But one thing is certain and we all agree on is that you can't count as mass market lines customers served by DS1 and above.

The problem that we are going to have with the data in this proceeding is twofold. One, staff has collected data

that did not ask to eliminate DS1-based customers and DS1-based lines. So the staff data that has been collected in this proceeding cannot be used in any, way, shape, or form for the analysis called for in the TRO. It is hopelessly contaminated by the inclusion of digital services with analog lines. It cannot be separated out. It's impossible.

BellSouth has collected some data using data requests that are clearly open to multiple interpretations. Some of them may have been filled out correctly, many of them wouldn't. At the end of the day, we believe the only data source you can really look to with confidence are data that the carriers have provided fully understanding the difference between analog and digital in the information they're supplying you and the billing records that the ILECs have, such as Verizon.

Okay. The bottom line. The ten-minute tour through every trigger company claimed by the ILECs where we will go through and separate for you why each one of these companies does or does not belong in the trigger analysis. It starts as a daunting list, but believe me, quantity does not actually substitute for quality here. These are the companies that the ILECs have named as providers self-providing switch triggers in the mass market in Florida. Four of them are discussed by the testimony of the individual company being named, AT&T, Supra, MCI, and Sprint; leaving us this list.

Now, fortunately, the FCCA was able to contact and

work with six of these companies to prepare affidavits that identify the number one piece of information you need to have to determine whether these are enterprise switches or mass market switches, and that is, how many of the lines on your switch are analog and how many of the lines on your switch are digital. As Mr. Magness indicated, the FCC doesn't have a rule that says a specific value. But what the FCC has clearly done in the TRO is indicated that, yes, they know that carriers that compete for enterprise customers are going to pick up in the normal course of business some analog lines. Customers aren't perfect. You go to a law firm, they might have a PBX, but they have a fax machine. So they -- you sell them a DS1 that connects to the PBX, but you've got to run an analog line to the fax machine for it to work. You go pick up a bank and they have a branch office. In order to sell the DS1 or DS3 services to the home office, you pick up a few lines at some branch office that may be analog. The world isn't perfect. There's some analog activity even with carriers that are enterprise.

What the FCC did tell us though when it looked out at this issue, it said, hey, we see these carriers that fundamentally are there to serve large business customers with high capacity loops, and then goes on to prove that they are there as high capacity carriers by pointing out that 90 percent of the capacity on their switches is digital capacity. When we look at the specific study that the FCC cites in coming up with

that 90 percent figure, down on that bottom row is the percentage of the lines that these enterprise carriers had that were digital. And if you look at it, basically what you see is these enterprise companies that the FCC looked at to determine that they were serving large business customers had about 80 to 90 percent of the capacity on their switches was digital. It's not 100. And there's one low one because the world isn't perfect even in Albany. So you end up with this range that the FCC looked at, and that's fundamentally what our testimony is to you. Use the same type of range. When we look at those six carriers, what we find is that they're safely inside that range of enterprise carriers. They don't count as mass market switches. That shrinks this considerably.

So now we've got to go through the rest of these individually. The first one is PaeTec. PaeTec did not give us an affidavit. However, when one goes to the PaeTec Web site, it is clear that this is a company focussed on the enterprise market. By it's own words, it's specializing in targeted solutions. When you look at their product offerings, they don't even list an analog voice product. Their first baseline product is a product called the Integrated T, which is the industry term for a DS1 digital pipe you run to a customer, and you allow that customer to mix voice and data traffic on it. Clearly the primary enterprise product offering, and it's the first one we see. So while we have a little more to go on than

this and some BellSouth data about this company, clearly that is the company that is focussed on the enterprise market.

Comcast. As Mr. Magness foretold, Comcast basically requires a judgment call by this Commission. The FCC has told you that when a company is not relying on the incumbent's loops but is relying on its own loops, that that evidence may bear less heavily in a trigger analysis. Well, I don't know how evidence bears less heavily in a trigger analysis. You've basically got two choices. You count them, you don't. Our recommendation without a question is you don't count them. You don't count them for a couple of reasons.

First off, one of the primary impairments that you're going to hear about is the impairments related to gaining access to the incumbent loop network to serve these POTs customers. And that's basically what this is about. There's a legacy architecture out there that was ratepayer financed that was built over decades in an environment of government protection from competition with rate of return regulation to give them the stable revenues to build this network. This is not the product -- I mean, we call it BellSouth's network, but that's only because they held title to it and inherited it out of these decades of government regulation and protection. To gain access to that network, we buy switching. The impairments are driven by access to that network. The purpose of a trigger and a trigger analysis is for you to be able to look out in the

market and say, well, because this person can do this, that must mean that the barriers have been removed. Comcast does not use the ILEC loop, so therefore, Comcast's operation in the market tells you nothing, nothing at all about whether those barriers have been removed. And the FCC has given you the discretion to not count them, and we recommend you don't count them.

We also think in the case of Comcast you have a special problem. Did Comcast really enter the local phone business using cable, or did AT&T exit it? Because what you really have in this situation is AT&T built up that local telephone business that is now Comcast's. They sold that cable business to Comcast, and Comcast let AT&T keep the switches. Comcast -- I mean, this may seem a detail, but it seems to be a very important one. It's very difficult to understand how Comcast can be a self-provisioning switch trigger when it doesn't have its own switch. And it's also questionable as to how committed they are to this market when the switch that they use to provide service they left with AT&T. Is this a judgment call to you? Absolutely.

SBC Telecom is the next carrier. Well, what can we tell you about SBC Telecom? You go back a couple of years, SBC merges with Ameritech. And in order to create the political atmosphere for the approval of that merger, BSC announces with enormous fanfare that the reason it's merging with Ameritech is

that it's going to embark on a national local strategy to bring local competition throughout the United States; that it's too small on its own to enter 30 cities and compete, but if it can just merge with Ameritech, it will be able to go out and be this competitor.

Now, as an aside, SBC's business plan for serving the mass market was UNE-P, but that's not relevant for this point. In order to get the merger approved, they promised the FCC that if the merger gets approved, they will actually go out and they will enter those 30 cities. And they promised they will do a set number of things. We'll put in a switch. We'll go sign up a couple of customers. And if we don't do what you told us to do, you can fine us $40 million. Now, based on that, that company, and we'll show the loop counts in a moment, has a trivial, insignificant share of customers in Florida, in fact, anywhere in the country. They have done the bear minimum to avoid a $40 million fine.

Now, does that company in any, way, shape, or form, BellSouth's strategic partner, demonstrate that barriers have been removed? No. It's simply an historical circumstance left over from its promise to regulators.

The next two come together now. Allegiance Telecom and XO Communications. When we first filed the testimony, it looked like Allegiance was going to be bought up by Qwest. Instead, it's purchased by XO. Well, what do we know about

this partnership? Well, we know that Allegiance successfully turned about $3 billion into $600 million. Hardly a recipe for success. Hardly evidence of nonimpairment. We know that the company that is buying XO is clearly an enterprise-oriented carrier. That's confirmed by what we have been able to see in the BellSouth data; it's confirmed by press statements concerning the merger. Our position is that you cannot use this named company, Allegiance, as a trigger candidate because you cannot find that they're likely to continue to do in the future what they have done in the past because you have to ask yourself a question. Which outcome is more likely, XO is going to change Allegiance's failed business plan to look more like its own enterprise, or Allegiance is going to change XO's and make them go and repeat the experiment?

Down to three. AllTel. Well, kismet. You know, the day we were getting ready to do this, they announced they're withdrawing, so that should be simple. Orlando Telephone, their Web site, absolutely clear. Services are for hospitality and business customers with a minimum of 15 lines. I told you earlier that the enterprise cutoff that the CLECs are recommending is 12. This company does not count as a mass market provider.

The last Indian standing, FDN. We are not in a position to disqualify FDN based on the data that's available. If there's a company out there that is potentially actually --

or qualifying self-provisioning switch trigger, FDN could be it. But we're also not telling you to at this point certify them in that role. And the reason is there aren't two other people to match them up with anyway. So why limit your flexibility and your ability to see how this plays out over the future by rushing out today to certify them, particularly when we believe one of the last criteria is an important criteria that you have to take seriously, and that is an investigation into whether FDN is likely to continue to do so. We're not asking you to do that now. Instead, we're suggesting, take FDN, put it in a parking lot. They haven't been proven to be a switch trigger, but they haven't been disproven either. They're certainly a legitimate candidate. Attempting to determine whether they're likely to continue to do so is going to require more time, more work, more information, but unless they're matched up with two other candidates, it makes no sense to go through that now. So we're asking you to basically reach a no finding on them without prejudice either way until it is a relevant question for you to answer.

Now, everything I just went through, I believe, fundamentally disqualifies all but one of those companies. But even if I hadn't, on your desks we have handed out part of what the FCC did when it did its analysis. And throughout the TRO, one of the things the FCC did was it looked at claims by the ILECs that said, here's a little bit of this, here's a little

bit of that, and the FCC constantly rejected that kind of de minimus level of competitive activity as proof of nonimpairment.

When we look at the BellSouth data -- and there are some disputes here that we don't need to get into. I took some of BellSouth's data and looked at it and calculated the share that each of their claimed trigger candidates had, and basically it still rounds to zero even going out to a tenth of a percent. Ms. Tipton took a different set of BellSouth data, but if you look at it, you realize, hey, whether you looked at it using their data or you looked at it using the data they gave us, the conclusion is the same. Even if these companies had passed through the question of are they enterprise or are they not, they still don't amount to enough for you to reverse the choices of 600,000 Floridians. Similarly, in the Verizon territory, we again have the one carrier that we all know is out there. But the other candidates in total still produce trivial levels of competition, particularly when you consider the companies outside of FDN. And you all have the confidential key that matches to these market shares, and you'll notice that the next largest provider in that territory has been disqualified on other grounds as well. Thank you.

MR. MAGNESS: Commissioners, our next presentation will be a panel presentation by the group of witnesses who are addressing the BellSouth -- I'm sorry. Our next presentation

will not be by a panel of witnesses. Our next presentation will be by Mr. Mike Reith of Z-Tel.

WITNESS REITH: Good afternoon. My name is Mike Reith, and I'm director of industry policy, Z-Tel Communications. Prior to the 1996 Act, the nature of local exchange service evolved very little. There was little impetus on part of the incumbents to translate the growing intelligent capabilities of their networks into enhanced services for local exchange customers. The unbundling requirements of the 1996 Act changed all that. UNE-P platform that includes unbundled local switching unleashed the powers of competition and innovation in the local exchange market. My company, Z-Tel Communications, provides a good example of that.

We initiated all types of innovations and enhanced services that made UNE-P possible. Through the development of advanced software, Z-Tel's vision to bring the power of the Internet, sophisticated databases, and messaging services to residential and small business customers via their regular telephone, Z-Tel's flagship residential product is Z-Line Home Unlimited. It's our unbundled, unlimited local, unlimited long distance, and personal voice assistance software. Our personal voice assistance software or PVA allows customers to create virtual address books, store contact information, make telephone calls, and send and receive voice e-mails simply by utilizing spoken voice commands through their regular telephone

handsets.

During the 2003 Retail Vision Conference, in which many of the top retailers in the U.S. participated, Z-Tel's PVA received the distinction of being named the best new technology. The broad distribution capability of UNE-P also allows Z-Tel to provide services to small businesses effectively and efficiently. An example of our growing small business services is Darden Restaurants. It's the parent company of Red Lobster, Olive Garden, Bahama Breeze, and Smokey Bones Barbeque. Restaurants like those that Darden own are not only statewide but also nationwide. They are as disbursed as the general population. Z-Tel obtained this national account solely because it had the ability to distribute two Darden Restaurants nationwide dial tone and PVA software. Despite the fact its restaurants are spread throughout the country, Darden can have the benefits of one contract, one bill, one service provider for 3,200 lines in 45 states. The ability to unbundle PVA to bundle PVA with local services, the functionality that UNE-P provides, is a crucial distribution channel for our software.

Among other things, broad distribution via UNE-P enhances our ability to offer software-based services by making advertising more efficient. Because we can take orders throughout the ILEC territory in this state, Z-Tel can advertise on television, radio, and in print. Virtually every

person that views an ad can purchase our service. If we were limited to serving only 50 or 60 percent of potential viewers, the effectiveness of these mass market advertising tools would decrease proportionately and subject consumers to the frustrating experience of inquiring to purchase this service only to find out that they live in the wrong neighborhood. Said differently, excluding 50 percent of the customers from its potential customer base would cause Z-Tel's cost of acquiring customers through mass market advertising to double.

The development of software is expensive and requires significant up-front investments. Z-Tel's access to capital is very limited. We believe that our limited capital is best spent investing in services and applications to solve problems or provide services not previously available. In our judgment, PVA and our intelligent dial tone technology is such an investment. Public policy should wish to promote that use of capital as well.

Limiting access to UNE-P would force Z-Tel and other entrants to redirect their scarce capital away from developing new services and innovations and into deploying Class 5 switches, meaning they would respond to the ILECs' plain old telephone service by offering the same old plain old telephone service and not innovative services.

In the end, the business of being a service provider is very different than the business of being a network

provider. Service providers such as Z-Tel focus upon customer support and building new features and functions and marketing and sales. The requirements to be a successful service provider include marketing savvy, good customer relationships, and the ability to offer new and innovative services.

As I mentioned earlier, UNE-P allows us to distribute our software and services as broadly as possible. If UNE-P availability is limited in certain geographic areas, our ability to profitably serve the remaining geographic areas would significantly be curtailed. It is entirely possible that if UNE-P were limited to certain areas of Florida, it would be uneconomic or unprofitable for Z-Tel to provide its UNE-P-based services in the remaining parts of Florida.

In addition, if we're denied our largest distribution channel, it may be difficult or impossible for us to effectively or efficiently develop and deploy software services. Only UNE-P works at a scale and scope that is necessary to support mass market competition throughout a state like Florida. If the Commission restricts or eliminates UNE-P availability in certain geographic portions of Florida, it risks consumers being denied a choice they currently have, and it risks ending or reducing investment and innovation software services like Z-Tel's technology. Thank you.

MR. MAGNESS: We could begin our panel on the BACE critique. I saw some eyes looking at clocks. We'd be happy to

take a break.

CHAIRMAN BAEZ: Yeah. I'm showing a 70-minute presentation. We'll let the court reporter get gassed up again, and maybe we can take a five- or ten-minute break before we get into a long presentation, if you don't mind.

MR. MAGNESS: Should we be back at five till?

CHAIRMAN BAEZ: Five till it is. Great. Thank you.

(Brief recess.)

CHAIRMAN BAEZ: We'll go back on the record. Mr. Magness, you've got your panel lined up?

MS. MASTERTON: Yes. And just for the record, to further endanger my role as emcee I have to admit that I butchered the names of my witnesses on this panel. Let me just reintroduce them.

CHAIRMAN BAEZ: Better you than me, Mr. Magness.

MR. MAGNESS: Dr. Brian Staihr, Kent Dickerson, and Christy Londerholm. Thank you.

WITNESS STAIHR: Thank you. Good afternoon, Chairman, Commissioners. My name is Brian Staihr and I'm an economist and I work for Sprint. And I'm here today with Kent Dickerson. He's the director of our costing group. And Christy Londerholm, she's one of Kent's people. And we're going to kick off the discussion of the BACE model, and after we've got things started, we're going to turn it over to Mr. Don Wood and Dr. Mark Bryant to finish things up.

Now, to kind of get us all on the same page, kind of level set to get things going, on the first slide here I put three bullet points, and what these are are three very simple things. In plain English, what does the BACE model do, how does the BACE model do what it does, and after it's done what it does, what does the BACE model tell us.

The first thing is it attempts to demonstrate, as we've all heard, the economic feasibility of a new entrant coming in and serving the mass market with its own switch. And in doing this it attempts to simply answer the question, can you make money in this business? Now, the way it attempts to answer this question is it takes information. Some of this information is data and some of this information is assumptions. And it takes these data and assumption and it mixes them up in a very complex system of calculations, computations, optimization routines, algorithms. They use Microsoft Access, Excel, Visual Basic, and it kind of churns them all up and it spits out some answers.

And the answers that it produces are pretty interesting because they tell us two things. First, they tell us that providing local service to the mass market using UNE-L not only is it profitable, it is extremely profitable. It is so profitable that it's more profitable than BellSouth's core business. In addition, it tells us that the FCC's national finding is wrong for every single major BellSouth market in

Florida. Now, we need to not get confused here because we have heard a lot of talk over the past couple of days, we have got this set of markets where we do triggers, we've got another set of markets where we do potential deployment, but BellSouth actually filed the results of this model for all their markets, including the trigger markets. And all of those trigger markets are, interestingly enough, amazingly profitable according to the BACE model.

Now, what this does, it let's us make an observation, and the observation is that the BACE model seems to single-handedly disprove the evidence that we have from the real world. But there's a problem with this because in any business case, and the BACE model is a business case, the results that you get depend on three things. They depend on how reasonable your inputs are, they depend on how accurate your calculations are, and most importantly, when you have to make assumptions, it depends on how realistic your assumptions are. The BACE models fails on all three of these levels, and because it does it's not surprising that the model's results run counter to what we actually see in the real world.

Now, because this is a business case, it has two sides. It has a demand side and it has a supply side or a cost side. Now, Kent is going to talk to you about the cost side, and I get to talk to you about the demand side which is fun for me because I'm an economist and economists love to talk about

demand. But more importantly, before I worked in Sprint's regulatory group, Sprint paid me to estimate the demand for stuff. It was my job to come up with how much they were going to sell, whether it was a new custom calling feature, basic local service, a bundle of perhaps satellite television and telephony combined. And I know that demand estimation means that if you get it right, you have to get it right, and if you get it wrong, it can be disastrous. Why can it be disastrous? It can make a business case go when, in fact, the business case wasn't valid at all, or it can trash a business case when, in fact, the business case was valid.

And to get it right, to get the right answer to this question of how many customers are you going to get, you have to do two things. You have to ask questions, and you have to investigate. And some of these questions are very simple, very straightforward. I have them up here. How large is the market? How is it growing? How fast is it growing? How many competitors are in this market? But some of them are more complicated. If I took my business case to the vice president of marketing and said, here you go, this is how many you're going to sell, basically he took it from me, threw it away and said, okay, Brian, tell me why. Tell me why these customers are taking my product as opposed to the other guy's. Am I pricing it different? Am I bundling it different? Does it have different quality? What is it that's driving this result?

And more importantly, the next question up there, how does the incumbent respond? All of these factors affect the market share, all of these are questions that have to be answered.

BellSouth's model not only does it not provide answers, it doesn't even ask the questions. So what does it do? It makes an assumption. It makes an assumption that we get 15 percent market share on average. That's a little misleading because if you look at what's really in the model when you're looking at residential customers who spend a lot, they actually get more than 15 percent of those guys, but when you look at the res customers who only spend a little, they get less than 15 percent. The same thing holds for small business customers. They manage to get a lot more than 15 percent of the ones that spend a lot, a lot fewer than 15 percent of the ones who don't spend much. Okay. So I'm making a big deal out of this. Does it make a big deal in the model? Absolutely.

We did a test. We took this 15 percent average, we changed it to 10 percent, didn't change anything else. The result of that one change was to reduce the NPV by 50 percent. You cut the amount you have in half by changing one assumption. So what do we know? It's important and it drives the results. So what do we need to do? We need to run a reality check. Let's look at the market share as we see in Florida based on your own evidence from the Commission's study on competition. You look at Miami, yeah, we've got 15 percent CLEC market share

for residential. We've got it because we have 78 CLECs there. In Fort Lauderdale, we've got 73. In Jacksonville, we've got 67. The BACE model models one CLEC, one CLEC in the market.

So our reality check causes us to ask some questions. Are they assuming there's only one CLEC in this market? If so, why? Where did the 77 other CLECs go in Miami? Do we assume they exited the market, or is BellSouth just basically pretending they're not there? We know they are. Or if there actually are more CLECs in the market, why does this one capture the 15 percent? If it's only 15 to 20 percent in Miami for 78 CLECs, does this mean 77 others are fighting it out for 3 percent market share?

Now, I need to be clear here. You have to make assumptions when you estimate demand. No question. But the assumptions have to be based on something. And this is a business case. It's not a theoretical exercise. So when you do a business case, the assumptions have to be based on the reality, and the reality is right now there are 78 CLECs in Miami, not one.

So after we've looked at the reality check, we turn to some other assumptions that they have made, not only what the market share is, but what the growth in that market share was, or in other words, how fast did they get those customers that they are counting on. The model assumes that if the CLEC is going to end up with 15 percent market share, it gets half

of that by the last day of the first year it's in operation. If ten years down the road you're going to have 15 percent of the market on day 365 of your operations, you have 7.5 percent of that market, and it also assumes that at the end of year two you've got three-fourths of that market. There's a reason for this. When you have a lot of start-up costs like a CLEC does, it really is a good idea to try and get as many customers as you can as soon as you can to cover those costs. It's a great idea. The only reason it's in there though is because it makes the business case work.

As with the case of the market share, the model results are very sensitive to changes in this input. If we change the year-one assumption and instead of getting half their market share they only get a fourth, which is still pretty aggressive, the NPV falls by 30 percent and that wasn't changing how many customers they got, that's just changing how fast did they get them.

Interestingly, this number, 50 percent at the end of the first year, which we refer to as the P value in the model, doesn't have support in the testimony provided by BellSouth from any real-world evidence. They didn't look at a CLEC in Florida and say they got that. They didn't look at a CLEC anywhere and say they got that. The support comes from one academic paper. It's a perfectly fine academic paper. It doesn't say the word "P value" anywhere in it. It doesn't say

50 percent anywhere in it, and it's not even about CLECs.

So given that we have these inputs that drive the results, when you combine these inputs, they work off of each other. And if you assume, as BellSouth did, they get a big market share, they get it very quickly, it essentially guarantees that the CLEC that's being modeled in the BACE model will succeed. And because both of those are affected by the number of CLECs in the market, but the BACE model ignores the number of CLECs in the market, we can't really know what we're supposed to be seeing as a result of these inputs.

When it comes down to assumptions in a business case, the reason a business case is different from a theoretical exercise is when you have to make assumptions, they have to be based in reality, they have to be well supported because, as I said, the demand side can make or break the business case. The assumptions that BellSouth has used on the demand side of their business case have no support and are unrealistic.

At this point I'm going turn it over to Kent who is going to talk about the cost side of the business case.

WITNESS DICKERSON: Thank you. Good afternoon, Commissioners. My name is Kent Dickerson. I'm the director of cost support for Sprint. I've worked for Sprint for 20 years. The last ten years I've had responsibility for all facets of Sprint in the area of cost analysis, and I've got extensive experience in the development of cost analysis and associated

models, including the BCPM. I had influence and input into the HCPM at a federal level. I was responsible for the development of Sprint's UNE models that went through the docket in this state recently and filed some TSLRIC studies recently in the state in the rate rebalancing proceeding.

I'm on Page 52 here. And a problem that was evident to me early on in my examination of the BACE filing was that it is populated with RBOC inputs which systematically understate a CLEC's cost of business. The model of inputs understate -- or overstate revenues, as Dr. Staihr just discussed, and they systematically understate operating expenses and capital for a CLEC.

Now, I have an exhibit here which was filed with my testimony, and my testimony sponsored Scenarios 7 through 10. And what we're doing here is looking at but a few of thousands of inputs in the model, and we are substituting what we believe to be accurate and more applicable to a CLEC operation input values to see what the effect is on the positive NPVs that were filed by BellSouth.

So starting with Scenario 7, BellSouth's filing assumed that a CLEC can purchase equipment, digital loop carrier equipment to terminate loops in their collocation cages and digital switching equipment at the same price as they can purchase from the equipment vendors. I believe it's an intuitive fact, an accepted fact in our industry that volume of

purchase affects price. It is an additional fact, if you look at BellSouth's network in Florida, they have approximately 26 times the number of digital loop carrier devices in their network in Florida as the CLEC that they modeled in their filing. They have approximately 15 times more digital switches in their network in Florida than the CLEC modeled in their filing. It defies logic to suggest with those kinds of differences that the CLEC could command the same vendor prices as BellSouth would.

Moving to the sales acquisition costs for mass market customers, which is Scenario 8. When we examined the input filed by BellSouth and compared it to Sprint's real-world CLEC experience serving mass market customers, we found that the input value was approximately 50 percent of what Sprint's real-world experience was to advertise and acquire and turn up service on a mass market customer.

Looking at Scenario 9, this was an input that added additional positive NPV outside of the ten-year period that was alleged to tie to the assumption that the CLEC at the end of their ten-year period would sell their assets and effectively either a new company picks up that business or that CLEC would effectively quit business. In either case, there's two important points. It's not a positive NPV that accrued from the business of serving a mass market customer. It accrues from the sale of the assets. And second, it's outside of the

ten-year period which, in effect, is already entirely too long and unrealistic as far as the ability to acquire capital. No one would lend on such a high risk venture based on an end of ten year NPV. They would look at it on a much shorter period, probably more likely half of that.

Then finally, in Scenario 10, I looked at the bad debt experience of Sprint's real CLEC experience and found it to be double the level of bad debt that was populated in the BACE model. Now, when you take but a few of these input changes that we've shown in Scenarios 1 through 10 and you take the cumulative effect, every one of these mass markets produce a negative net present value. So what we're demonstrating here is when you populate the model with inputs that are consistent with a CLEC's experience, it demonstrates what you see in the real world, which is mass market customers have not been profitably and cannot be profitably served using a UNE-L entry strategy from day one. Economies of scale still matter in this business.

Moving to Page 53. I looked at the area of collocation costs, and I found dramatic cost understatement in this area. I found that BellSouth's filing excludes, does not include the CLEC's cost to build DC power cables, and as a result, the up-front costs of constructing collocation were understated in excess of 500 percent. I looked at the monthly recurring costs of DC power consumption and learned that the

BellSouth approach used a one size fits all 60 amps of power for every collocation. The effect of that is to provide insufficient power for 82 percent of the collocations modeled in the model. It's a simple comparison of the equipment required to serve the demand that they have modeled and the power requirements to run the equipment. Eighty-two percent of them would not function, and the result is 198 percent understatement every month of every year in the ten-year period for collocation power consumption.

A third effect of this is not only the understatement on the NPVs but due to the optimization routine that alleges to pick the least cost between EELs and collocation. A use of costs that are consistently understated by 500 and 198 percent will always yield an errant result.

Moving to Page 54, I turned attention to the operating expenses and found that BellSouth had used a grossly simplist approach to predict 33 percent of the CLEC's operating expenses, and they did this by an unfounded assumption that every dollar of revenue for the CLEC could create 25 cents of what they termed erroneously to be G&A expense. Well, there are several problems with this that I'll walk you through, but the first problem that's apparent is it creates a fictitious result that in the early years of a CLEC's entry into the market when revenues are minimal, that they have an unrealistic ability to hold costs to zero. That's not the way the real

world works. And it's this direct variable cost approach that's divorced from the real world, and it serves to systematically understate the costs of the CLEC's operations, particularly in the most critical portion of the business case which is the early years.

Moving to Page 55, still concentrating on this single factor that was used to develop 33 percent of operating expense. The approach used to develop this factor by Dr. Aron was to derive it off of a regression analysis derived from ARMIS data filed by the largest ILECs in the world, those being SBC, Verizon, BellSouth, Pac Bell, and Ameritech. It would be difficult to select a more polar opposite than the cost structure of these largest ILECs in the world to those of a start-up CLEC, and yet that is exactly what they've done.

We further provided additional evidence to staff and data requests that showed that these G&A expenses do not bear a direct variable cost relationship to revenues. They are, in fact, much more fixed cost in their nature. And we showed that there's a definite correlation to the size of the company that was obviously ignored in BellSouth's input approach. Smaller ILECs have a higher cost relative to larger ILECs, and more importantly, start-up CLECs have a dramatically higher cost relative to ILECs, particularly in the early years of their operation.

Yet another glaring error in this one-factor approach

to CLEC operating expenses is shown on Page 56, where BellSouth has created a new definition for G&A expenses that I have yet to encounter in my tenure in the industry wherein they took obviously plant-related, investment-related expenses that I've listed here, and they have contended that these are G&A expenses. Well, what's important about this is these are expenses that are incurred when the CLEC enters the market and they have to engineer, construct, purchase, and put plant into service. It will take years for these equipment items to fill up and have matching revenue streams, and yet the approach that they used where they buried this in a factor that is directly tied to revenues allows them to depict a fiction which would be that these costs do not exist until and unless a revenue stream is put in place on the equipment item. The reality is these are plant-related expenses, and they cannot be managed in lock-step to the presence or not of revenue streams. They are incurred when the assets are put into service.

Moving to Page 57. I wanted to do a simple test of the capital requirements that were modeled in the BACE model. And I want to be clear here. It is not my testimony that I believed that the CLEC's capital is equal to Sprint's local division capital which was approved by the Commission in the UNE docket; rather, my expectation is that the CLEC's capital per line would exceed Sprint's. Sprint has 8 million customers nationally, and we have over 2 million, almost a threefold

increase compared to the customer base that BellSouth modeled for this CLEC at the end of the ten-year period. So Sprint is much larger. So I would expect the CLEC's capital per unit to be higher than what I saw the Commission approve for Sprint. And unfortunately, I see a dramatic difference in the other direction. Looking at the digital switching, we looked only at 61 host switches selected out of Sprint's Commission-approved UNE cost. And everywhere where you see those percentages exceed 100 percent, that's telling you that Sprint's UNE cost exceeded the BACE model's modeled CLEC capital by in excess of 100 percent. In eight of the ten years it's dramatically understated. The digital loop carrier devices were even more dramatically understated, in excess of 200 percent. And this is yet another example of Bell's unrealistic use of their internal RBOC costs for switching and digital loop carrier investments systematically understates the CLEC's costs.

Now, turning our attention to Page 58. This BACE model is largely untested. And I'll not dwell on it, but it's an unfortunate circumstance that it was cloaked in secrecy for effectively the entire proceeding, and yet it's even more telling that with a very limited amount of testing we have found glaring and alarming errors in the calculations of the model. Now, what we're doing here is testing sensitivity to the output of the model, the NPV outputs that are relied upon by BellSouth to make their nonimpairment argument. We were

testing it by changing a single cost input, that being sales acquisition costs. And you can input that into the model in two areas, mass market and enterprise. And so what we did in Column D here, what I would draw your attention to in Column D is that you see on Line 1A, which is Column D, Row 11, there's a $25 million pretax loss for mass market customers. This model produces the illogical phenomena that the impact of income taxes can turn a $25 million pretax loss for mass market into a $54 million profit, which is shown on 1B. It defies logic. Income taxes cannot turn a $25 million loss into a $54 million profit.

Now, in Column E, we increased the sales acquisition costs for both mass market and enterprise customers. And I would draw your attention to the fact that 2B, this is Column D, Row 21, that started with a $95 million loss, post-tax loss for enterprise customers, and this model suggests a phenomena that by increasing sales acquisition costs for every one of those enterprise customers a $95 million loss would be converted to an $8 million profit. It cannot be explained, and the model is clearly unsound.

I'll point out yet one more instance which is Column G and if you look at Figure 2D. In Column G what we did here was we held the sales acquisition costs constant for enterprise customers, and we decreased them for mass market. So important for your understanding is we're introducing no changes to the

enterprise market customers. And this is compared to Column E. And so if you look at Figure 2C, I'm in Column E, I'm on Line 21, there's an $8 million profit for enterprise customers. Introducing no changes to that customer segment and introducing only a decrease in sales acquisition costs for mass market customers produced the illogical result of an eightfold increase in the profitability of enterprise customers. It goes from 8 million to 66 million. Now, Mr. Stegeman was grilled about this in his deposition, and he, quote, admitted that the model produces anomalous results. He's filed a late-filed deposition (sic) which attempts to blame us for changing sales cost inputs and somehow that this would impact these tax calculations. Just ask yourself, why would us varying sales cost inputs have any logical effect on income taxes? The answer is, it wouldn't. And what I'm telling you is this untested model is unsound, and the calculations are obviously grossly in error.

Now, moving to Page 59. I performed a real simple reasonableness test. Mr. Magness referenced this in his opening. I think it's extremely telling. We took the output of BellSouth's filing, and we computed the internal rate of return on capital. It's 37 percent. I went and looked at BellSouth's external financials for 2002. They earned a 10.6 return on capital. If BellSouth expected that this was even remotely possible in the real world, you would see them

entering outside of their territory in Florida and you do not. You see no real-world results that reconcile to this phenomenal result.

In summary, the BACE model is built on RBOC inputs which do not accurately predict CLEC outcomes. It systematically overstates CLEC's revenue streams. It understates their operating expenses. It understates their capital requirements and their cost of the capital. It produces erroneous and unreliable results. And its NPV results showing positive mass market entry from day one with UNE-L is contrary to all real-world experiences and data. And lastly, I demonstrated at the outset that but a few of these inputs are populated with logical CLEC experience and data. The results then reconcile the real-world experience and showed the results to be negative. Thank you.

Don Wood with AT&T will now discuss pricing.

WITNESS WOOD: Good afternoon, Commissioner. By way of background, my name is Don Wood. I'm an outside consultant for AT&T. I have an undergraduate degree in finance, Master degrees in finance and economics. I've spent the last 15 years working in this industry, not at a high academic level but at the ground level, at the get your hands dirty detail level of issues related to how costs vary in networks, about how prices are driven from those costs, and about market entry considerations. I first testified before this Commission on

cost issues in 1989. I participated in all the major cost proceedings since then and in about 200 similar proceedings at other state commissions.

Dr. Staihr talked to you about how important the revenue side to the calculations are in the BACE, and he's exactly right. He talked about the quantity side of the price times quantity calculation. I want to talk to you about the price side.

The TRO gives us very clear guidance. The determination of whether entry is economic depends on a forecast of likely future CLEC revenues, revenues that are likely -- ought to have some basis and some foundation. That's true with the quantity; it's also true with the price. Future prices and future revenues are by nature uncertain. They are, of course, highly uncertain the further out you go over an extended period of time. And because the BACE locks in a ten-year period for consideration, we are dealing with this extended period, and we are dealing with this high level of uncertainty. And in this industry ten years is time for a whole lot of things to change.

In any business case analysis, the price that's considered has got to be the expected price over time. It's essential especially if you're locking in a ten-year analysis to consider the price changes that can occur, and it's also essential to consider how the revenue potential varies by

market, that the current prices vary by market. This is the granularity that the FCC keeps coming back to in the TRO, and it's the granularity that it didn't have in the data that was before it when it reached its decision. And there are numerous paragraphs that cover this. Paragraph 425 talks about the revenue potential as it varies dramatically among residence and business customers in different areas within a state. Paragraph 485 talks about the significant variation in cost and revenue that have to be considered.

Here's what BellSouth assumes. BellSouth assumes that in a competitive market and over a ten-year period, from the time they ran the study until the year 2013, prices for all mass market services will be maintained at current levels. That is not likely future revenue. And I don't think we have to go to theoretical academic research to support that. There are a couple of realities that need to be considered. The first is, you know, we've got the interexchange example to look at in terms of making markets competitive. And in the ten years after divestiture, interexchange toll prices declined by about 5 percent per year on a year over year basis, and they dropped by a third in the first five years. And there's been some discussion about, well, aren't these price reductions just a reflection of reductions in access? Huh-uh, not in the first five years. That's a period of time when the effective access rates were increasing, not decreasing for both the dominant and

nondominant carriers, and yet they managed to reduce prices by a third.

The second reality, and this is an important one, BellSouth says in its annual report, and it quotes its CFO in a press release, "BellSouth is currently operating on 'the bleeding edge' of aggressiveness with regard to its Winback Program." There have been some question posed, and I think the staff posed the question in a data request. If competition is going to drive some of these prices downward, why don't we see BellSouth reducing prices in some of these markets? And the answer is, they are, but they are doing it on a very selective basis because with the winback you have the best of both worlds. A customer that's left you, a customer that's likely to seek an alternative, you can offer on a targeted basis the price reduction to them that you need in order to keep them, but for everyone else who hasn't demonstrated a propensity to leave, you don't have to incur the cost, the revenue hit to offer that discount.

Winback ultimately represents the rate against which CLECs have to compete because it's the rate that BellSouth offers to CLEC customers in order to win them back. But in the BACE, BellSouth assumes that the current tariffed rates are the rates that are the market rates against which the CLEC has to compete. Now, BellSouth certainly has -- when it loses a customer to a UNE-P provider, it has an incentive to win that

customer back because it is foregoing an amount of money or losing an amount of money that's the difference between the retail and the wholesale price. Unlike Dr. Aron, I did participate in your UNE cost cases, and I do believe your UNE-P rate is compensatory. So what you've got here is BellSouth losing the wholesale versus retail amount. That has been sufficient so far to motivate them to the bleeding edge of aggressiveness for winbacks.

Now, let's look at what we're talking about at UNE-L. Now we're not looking at them recovering on a wholesale basis part of their switch cost the way they do under UNE-P. Now we're talking about the difference between the retail cost and nothing. If they were motived to be this aggressive in winback for the difference between retail and wholesale, how motivated will they be for the difference between retail and nothing at all? I don't know what level of aggressiveness is beyond the bleeding edge, but I expect you would find out. To assume in this model that current tariffed prices represent likely revenues for CLECs and the rates they have to compete against is extremely naive. These winback rates are what CLECs compete against. And it turns out it matters quite a bit, like a lot of the other assumptions.

If we assume that Dr. Aron is right, that a CLEC can capture 15 percent market share and can capture half of it in the first year, I don't think she's right, but assuming that

she is, BellSouth hasn't accounted for the winback in the BACE. What they say in their annual report and press releases is that for every two customers that they lose, they get one of them back on winback. In other words, they have got about a 50 percent recapture rate. It's a little higher on small business, it's a little lower on residence. But if we take that 50 percent and we assume that CLECs have the ability to capture customers at the rate Dr. Aron says they do, they are also giving back one customer for every two they gain. So their ultimate market share is overstated in the BACE by double just because of this and their rate of customer acquisition is doubled in the BACE because of this. When you adjust just for what BellSouth says is their current level of winback success, winback success motivated just to retain that retail versus wholesale piece, not the retail versus zero, the net present value in the model goes down by 70 percent just from that change alone.

Now, the FCC provided additional guidance. They said, and this is, I thought, obvious but apparently not, "Entry is more likely to be economic in areas with high retail rates relative to cost." But of course, in a competitive market those are the retail rates that are the least likely to be maintained over a period of time, particularly a ten-year period of time. In order to accurately predict these price changes, you have to look at existing prices, and you have to

look at them at the necessary level of granularity. And it's the granularity that the FCC kept coming back to.

Now, this isn't the same as defining the size of the market. You can look at prices at a market level, but within that, BellSouth doesn't charge the same price to all the customers within the markets that it defines. It has its pricing based on wire center distinctions and rate groups of those wire centers. Its costs and its rates vary at the level of the wire center. So if we're going to look at how prices are going to change over time, we've got to begin with data. Even if we are going to compile it into larger markets later, we have got to begin with the analysis at the wire center level. The BACE cannot do that. It preprocesses or BellSouth preprocesses this essential information into some tables that are locked and given at the beginning of this model process. You cannot go to the necessary level of granularity in order to predict in any meaningful way how these prices are going to change over time. And this is not something we can fix simply by changing some inputs because these are values that are in the pricing table that go into the model before we get it.

Now, the price granularity problem is compounded by BellSouth's customer segmentation process. The BellSouth approach is that customers need to be divided into segments based on their spending patterns, five segments for residence, three for small business as they define them. There's a couple

of problems. First of all, it's a direct violation of the TRO. BellSouth actually did this kind of analysis, as did SBC, and they presented it to the FCC when the FCC was collecting information before it issued the order. And the FCC looked at BellSouth's analysis and they rejected it. And they rejected it for a specific reason, because it failed to use the likely revenues to be obtained from a typical mass market customer. In fact, BellSouth presented previously data based on atypical mass market customers and that are ones who spent more money.

The development of the BACE model began before the TRO was issued, so it's probably not a surprise that what it does is an extension of the analysis that BellSouth gave the FCC the first time. More sophisticated but the same analysis based on atypical customers, not typical customers moving from BellSouth to CLEC.

The second problem is a little more esoteric but it's an important one, nevertheless. BellSouth when it assigns these customers to these different customer segments based on spending ignores why those customers are spending more. Some customers spend a lot because they buy a lot. No doubt about it. Some customers currently today spend more than others because they happen to live in an area where BellSouth has higher rates than other areas. Now, the first group of customers, those that buy a lot, are probably likely to be big spenders over the next ten years. Those that are right now

spending a lot because they're in a high rate area are probably not likely to be big spenders over the next few years. But what the BACE does is it assigns a disproportionate number of these people to CLECs, and then assumes that they're going to continue to spend that amount of money throughout the process. That's not likely CLEC revenue either.

BellSouth assumes that there's going to be a 15 percent market share at the end of ten years. And the 15 percent assumption applies according, and "Direct at 24" refers to Dr. Aron's testimony, this market share assumption applies to all customer segments. It turns out it doesn't apply to any customer segments. They don't actually use the 15 percent assumption for any of the residence segments they identify; they don't use the 15 percent for any of the small business. In fact, what they do is they pick different percentages for different segments in order to create not a typical mass market customer for this hypothetical CLEC but a very atypical.

And the next couple of pages are screen captures from the BACE model. Now, I've had to put some black rectangles up here to cover the numbers because BellSouth considers them proprietary. I don't know why BellSouth's projection of a hypothetical CLEC's market share is proprietary to BellSouth, but nevertheless, it's protected. But without the red blocks, you would not, in fact, see a 15 percent anywhere on that page

even though that's the ultimate market share percentage for the five residential segments.

Same thing for the one- to three-line business. There's no 15 percent there either. And, in fact, for the big spenders in the small business market, I can't tell you what the top number is, but if you assume that they are going to get half their market share in the first year, we're talking about more than 15 percent market share gain for that segment customers in year one for this CLEC. That's not likely CLEC revenues in the future either.

So we've got an assumption that's based on atypical customers. It's the same analysis, more sophisticated, but the same analysis that BellSouth presented to the FCC, and the FCC rejected for exactly that reason. They based their expected CLEC revenues on prices that are the least likely to be sustained, will, in fact, be sustained, and they assigned a disproportionate number of those customers to this hypothetical CLEC. But because these assumptions are preprocessed, you cannot change and reflect the likely changes in prices within the BACE because the granularity problem still arises. Prices are set by BellSouth currently at the wire center exchange level. Even when you group those into markets, what they treat in the model is an average for that market and that's what's in that table. We can go to the product price table, and we can change prices over time, but we cannot make them more granular.

They are locked in at BellSouth's market definition. We can't change them more discreetly than that.

The second area that I'm covering is the calculation of net present value because that's what the BACE does. It's a business case model. It looks at likely revenues. It looks at likely costs, calculate the NPV, a very straightforward process. Not only are the revenues and costs key assumptions but obviously the discount rate for the NPV calculation is another very important assumption. In order for the results of any business case to have meaning, the discount rate must, and I put must there in italics, and must it is, accurately reflect the risk associated with the potential investment. If you err in this assumption, you err in your business case model.

The relevant risk for the CLEC, and what we're talking about here really is the CLEC's cost of capital because that's what comes in here as the discount rate, is a function of several factors. It's a function of the availability of capital in the industry; it's availability of the risk of this industry segment, and right now, CLECs are considered to be a fairly risky industry segment; risk that's specific to the CLEC's operation, and that's the business and financial risk components; and the risk that's specific to the investment being considered, in this case, investment in what Dr. Aron calls a large sunk cost that increases risk.

Now, according to Dr. Billingsley -- and some of this

are his words, some of it is articles that he cites in his testimony -- the entire telecom industry is competitive and risky and growing more so with the passage of time. I think he's right. We ought to predict tighter profit margins and falling prices for voice and data services. He's probably right about that too, but that's not what BellSouth did in the BACE. There's an ongoing drought in the capital markets with regard to CLEC investment. He's definitely right about that. I've been involved in several facets of this. I used to get calls from venture cap firms to review CLEC business plans for them. I haven't been getting those calls the last few years, don't know of anybody who has. Those people have been burned. They are not looking to invest in these companies. And there's a reason why, and Dr. Billingsley states it in his testimony. The reason for previous CLEC bankruptcies is well known. The CLECs acquired billions of dollars in financing to invest in telecommunications infrastructure based on inflated demand forecasts, not unlike the BACE, and when this demand did not materialize, the CLECs were left with billions of dollars in debt and no way to pay it off. And I think he's right.

And in the late 1990s, to put it fairly directly, there was a school of hard knocks for CLECs and for investors, and quite a few CLECs, some of them fine clients of mine at the time, never graduated from that school. In fact, some investors didn't graduate from that school either. But there

was a lesson for those who did, and that is that large fixed investments in network facilities need to be considered very carefully. Prudent entry strategies are likely to be based on a mixture of owned and leased network facilities. That was one of the lessons that was learned by the companies that, frankly, are still standing. And that's what this is all about. This is a lease versus buy decision in a significant way. For some network facilities, it's prudent currently to buy them; for some, it's prudent currently to lease them.

Now, given this background, Dr. Billingsley calculated -- and he used standard discounted cash flow and capital asset pricing model methods, and I don't take issue with the methods. He's noted the increasing level of risk, he's noted the declining margins, he's noted the previous experience of CLECs who incurred large amounts of debt, he notes in his testimony the difficulty that he had finding financially solvent publicly traded CLECs anywhere to use in his analysis. He calculates a cost of capital based on the CLECs he could find that are using UNE-P and UNE switching to serve mass market customers if they're serving mass market customers at all.

And what he did was after considering all of those, when he's looking at a CLEC that's going to make the large sunk cost that increases its risk, rather than adjusting his cost of capital upward, he adjusts his cost of capital downward. He

calculated, based on the CLECs he could find, the UNE-P providers, a cost of equity of 20.78 percent, a cost of debt of 13.4 percent, but he recommends an average cost of capital that goes in as the discount rate to the model of only 13.09 percent in pretax amount. He gets there by averaging the results he actually got with the results that he got from taking the entire S&P 500 characteristics, and he takes a midpoint between the two. In other words, CLECs today with their current operation have a level of risk when they go and make this big sunk cost investment in local circuit switching, what Dr. Aron says increases their risk, their, in fact, cost of capital is going to move toward the S&P 500 average rather than increase it. It turns out this is one of those inputs that matters too because if you go back just to Dr. Billingsley's original calculation, what he really calculates for CLECs before he adjusts it downward toward the S&P, and use that as the discount rate, the resulting NPV drops by over a third just from that change. It matters.

So in the end, BellSouth ignores some pretty common sense questions that aren't really academic in nature at all. Why will a CLEC that incurs the greater risk to self-deploy local circuit switching enjoy in the future a lower cost of capital than a CLEC using UNE switching does today? By underestimating this cost of capital and the discount rate, you overstate in the BACE substantially the net present value of

the purported business case.

And the second issue is one that hasn't been focussed on a lot but I think we better start. Where are the billions of dollars in capital going to come from? Let's assume BellSouth is right that the BACE is absolutely right, and I couldn't tell you in my 200 pages of testimony all the reasons why I think it's wrong, but if it's right and we're going to remove UNE-P, we're going to transition these CLECs to UNE-L, and there's going to be fewer CLECs in the market, but there's still going to be some standing, they're going to go out and have to buy these switches, and the money has got to come from somewhere. Where? You know, we can look at Florida, then we start looking at the same situation around the country. Where in the current capital markets are these tens of billions of dollars in new CLEC investment going to suddenly come forth? Because if they don't, then it doesn't matter what the outcome of the BACE is. The impact on Florida consumers is the same. Removing UNE-P means removing their competitive alternative for their current service.

That's the impact on consumers that we get to at the end of this process, and whether you believe their analysis or you don't believe their analysis, in order to conclude there's no impairment, you've also got to conclude that the CLECs can go out and find somebody to lend them the money at any price to make all the necessary investment. And I'm going to turn it

over to Dr. Bryant at this point of MCI.

WITNESS BRYANT: Thank you, Mr. Wood. I always get accused of having a very soft voice, so let me know if you can't hear me. Good afternoon. My name is Mark Bryant. I have a Ph.D. in economics and public policy from the University of Texas at Austin. I have over 20 years of experience in the telecommunications industry. For most of my career I was employed by MCI. I participated in early versions of the development of the BCPM model, and for about seven or eight years I managed MCI's participation and the development of the HAI model.

What I'd like to do, if we can get our slides up here, is to give you a little bit of a public policy context in which I think you should evaluate the claim nonimpairment that the BACE model produces. The FCC decided in making its national finding of impairment -- their national finding of impairment hinged on basically two findings. The first that there are severe operational problems with the provision of UNE loop service. And you're going to hear from some witnesses later on today about those problems and what impact they have on the CLEC's business and on the CLEC's customers. The transition, assuming that CLECs are able to make the transition on an economic basis at all, is going to be a major change in the way that CLECs do business.

The second leg of the FCC's finding of national

impairment for mass market switching was that they believed that there would be some economic factors that might prevent the CLECs from operating without access to the unbundled switching. The point I'd like to make here is that although those are two separate issues in the order, they really do have a lot of interrelationships. And that's something that the BACE model and, for that matter, the analysis that I presented don't really consider, and the reason is that it would be speculative to try and consider the cost of those problems.

If the CLECs do experience the kind of operational problems that our operational impairment witnesses have referred to, that's inevitably going to have an impact on their cost. It's going to raise their cost of doing business, and it's going to have effects on many of the key inputs to the BACE model that I think you need to keep in mind.

One overriding thing -- and I'm not a lawyer here. I'm not going to try and tell you how much discretion you have, but I think in evaluating the results of any potential deployment model, you probably have more discretion than you do in any other part of the case. But I think you need to ask yourselves whether that model gives you sufficient confidence that the consumers in Florida are going to continue to enjoy the kind of benefits of competition that they enjoy today in the UNE-P environment.

I'm not saying you're going to make an error here.

It may be that you'll get it just right. But there are two potential kinds of errors that you can make in this case. And one kind of error that you could make is to find nonimpairment where, in fact, the impairment does exist, to make a mistake in that direction. And I think you need to consider the consequences of that. If you find on the basis of the results produced by the BACE model or by my analysis or any other tool that impairment doesn't exist, what you may -- and if that finding is in error, what you're going to see is the exit from the market of the competitive carriers. You're going to see the elimination of competitive alternatives, and you'll see BellSouth recreate the monopoly that it enjoyed prior to divestiture. It will be an integrated local and long distance company with which no one else can compete.

BellSouth has said that they will continue to provide unbundled switching at what they call market-based rates which always kind of gives me pause because I think that they have admitted in this case that there really isn't a market for unbundled switching. They haven't cited any other wholesale provider of switching services. So it's kind of difficult for me to see what that market-based rate -- or what market that rate might be based. What that's really saying is that BellSouth will be able to control the costs of its competitors and will be able to control the rate at which they're able to enter the market or whether they're able to stay in the market

at all.

A second kind of error that you could make is to find impairment where, in fact, the CLECs aren't impaired. Now, that may be a mistake, but it won't have immediate effects on Florida consumers, and in large part that kind of error would be self-correcting. It permits the competitive carriers to go ahead and build their market share and make the self-deployment more feasible. You will actually see them begin to use the UNE-L mode of entry, and as a result, the CLEC demand for UNE-P will begin to decline. And I believe that over a period of years you may see UNE-P not really used at all by the competitive carriers.

BellSouth makes a lot of the need to recognize the economies of scale that exist in switching in doing the potential deployment analysis. Given that some CLECs already have switched, why wouldn't they want to take advantage of those economies of scale now and expand their service offerings to the mass market? The fact is that they're not doing that today, and you have to ask yourself why. And I'll try to provide some of the answers to that here in a moment.

I think you need to ask yourself, can BACE provide the answer? There are a couple of things that I think you need to consider here. I looked at the model, and when I filed my testimony, I said that if you make material changes to some key inputs, you are going to see little change in profitability.

And we talked two things in particular, changing market share and changing churn rates. And BellSouth was pointing to this in their presentation and saying that we can't even agree about whether changing inputs makes a difference. Let me just say that I was looking at a somewhat different measure of profitability than Mr. Wood was or Mr. Dickerson who saw a rather greater sensitivity. I was really looking at the number of wire centers that would go to negative net present value if I changed its churn rate or changed the market share. And I wasn't seeing any of that change by changing just those inputs. In fact, the number of wire centers that were profitable remain more or less the same. I think the problem was in my analysis that there are so many unrealistic assumptions in the default case for BACE that changing one input really has little affect on the overall profitability of individual wire centers. Also, in my testimony, I presented runs of BACE that combine several of the key inputs and changed those, and I think there you saw a rather more dramatic in the net present value and a lot of wire centers that became unprofitable.

Let me also say kind of in a "me too" fashion to Mr. Dickerson's presentation that I too saw some illogical results coming out of the model. One example in particular that I cited in my testimony is that when I increased churn from 5 percent to 6.5 percent, I saw some wire centers becoming more profitable rather than less profitable which is a result

exactly contrary to logic.

Beyond whether BACE can provide the answers though, I think you need to ask yourself, can any model provide the answers to this potential deployment question? There is a great deal of lack of certainty in all the models, that's the BACE, the analysis that I present, and primarily that's because many of the most important inputs to the model are unknown and unknowable. We can't really know what the customer acquisition costs are going to be in a UNE-L environment. We can't really know what the churn rates are going to be in a UNE-L environment. And the cost of overcoming the operational problems is unknown and, as I said before, not even considered.

Let me talk a little bit about how these are interrelated. There's some problems. There was some questioning earlier this morning, I believe, about whether CLECs would be able to provide the same quality of service using UNE-L as they do today using UNE-P. And I think that the fact is that there may be some quality of service issues that come about. One in particular is that where a customer is served over integrated digital loop carrier, the CLEC, for one thing, will now be able to provide DSL service but, for another, may have problems or his customers may have problems in using even analog modems. Where there are no copper facilities-based available to serve that CLEC and the CLEC's lines have to be taken off of that integrated digital loop

carrier system, the quality of modem transmission is inevitably going to be degraded. Customers are going to be unhappy with that. They're going to come to the CLEC and say, well, how come I can't connect to AOL as fast as I used to? And that's going to cause some customer dissatisfaction, and it may cause an increase in the kinds of churn rates that we've been experiencing in the UNE-P world. It's also going to cause the CLEC's customer acquisition cost to increase because they're going to have to spend more money convincing customers that they should subscribe to the CLEC's service even though they may not get as good modem connections. And that's just one kind of example of how we don't know based on today's experience what the inputs are going to be if we were to move to a UNE-L environment.

Really, the only certain evidence that we have is what the real-world behavior of competitors is. And those carriers that have deployed switches generally are not using them to serve residential consumers. We have to ask, why not? Well, there are a lot of factors that are important in determining the profitability of CLEC UNE-L entry, including the cost of switching, the cost of developing OSS, and the cost of putting together their sales organizations, but even for CLECs that have already developed those systems and already own switches, they aren't expanding out into the mass market. And a critical factor that determines that is the cost of

establishing collocation and the cost of establishing the backhaul to aggregate all the traffic in all of those wire centers in the mass market back to their own switching systems. There is a massive investment to be required in establishing those collocation spaces, in equipping them, in providing them with power and doing that ubiquitously because, after all, we are talking about the mass market.

If I'm approaching a market like Miami and I find that it's economical to me to establish collocations in only half of the wire centers in the market, it's real difficult for me to see how a mass marketing strategy that would use radio and television or even telemarketing is going to work. And without that critical mass of customers in each of the wire centers in a metropolitan area, mass market service just isn't feasible.

So I'd like to kind of sum up by saying that Dr. Staihr has shown you the problems with the BACE's demand inputs. Mr. Dickerson has shown you the problems with the cost inputs and the calculations and some of the illogical results that it produces. Mr. Wood described the faulty revenue and cost of capital inputs. And I've given you a little bit of the public policy context. And I think that the only reasonable conclusion, given all that we've shown you today, is that BellSouth's potential deployment case for mass market switching does not provide the kind of confidence that the Commission

needs to have in order to overturn the FCC's national finding of impairment. Thank you very much.

MR. MAGNESS: Thank you, Dr. Bryant. We're ready to move to our next panel; that is, the operational impairment hot cuts panel. And the participants in this panel will be from AT&T, Mr. Mark Van de Water; from MCI, Sherry Lichtenberg; and there's Mr. Nilson representing Supra.

WITNESS VAN DE WATER: Good afternoon. My name is Mark Van de Water. I'd like to give you a little bit of my background too. I have 26 years with AT&T. Sixteen of those years was at Western Electric cable plant. I probably made some of the wire that appears in some of these central offices that are here that are done with the hot cuts that you are going to see a video of in a little bit. The last five years I've worked in the AT&T local services division helping to assist with AT&T business local services and the SBC Corporation to get through some operational issues initially with the UNE loop product and then the UNE-P product. The last six months I've been participating in and facilitating often hot cut and CLEC facility demonstrations around the country. I've done these in the Qwest regions, the SBC regional company regions, and of course in the BellSouth. And one observation I can share, hot cuts are performed the same everywhere. From Tucson to Tallahassee, it's the same thing. It doesn't matter, as Mr. Gillan said. It was the network that was made back

before there was any -- there was only one company. It's the same thing.

Now, the FCC has found that hot cuts do cause impairment. There's a practical limitation. They're labor intensive. They're very manual. Hot cuts require the expenditure of substantial ILEC and CLEC resources and can generally impose prohibitively high external and internal costs.

There can definitely be provisioning delays, service outages which then causes customer dissatisfaction. This is not CLEC speculating. We're not dreaming this, it happens. It's a manual process. Service disruptions were found by the FCC that it does cause impairment. It will hamper our ability to offer competition. The mass markets now, they demand reliable, easy to operate service and trouble-free installation. They do not expect to have their service go down when changing local carriers.

The FCC found that it is unlikely that incumbent LECs will be able to provision hot cuts in sufficient volumes. That's a concern. As we've heard about churn already, the mass market customers do like to shop. They like to find the best deal. They want to go to the carrier that's offering the best price. There's going to be changes. There's always going to be movement. And the customers today expect to be able to move in a seamless and rapid manner as much as they want to without

having any kind of downtime.

AT&T's hot cut experience, it was pointed out, the deposition was from 2001, we were in business from 1999 until 2001. That's true. We still offer some hot cuts today. Supra is going to talk about activities that's happening now. BellSouth tried to say that the CLECs are only speculating. We're here to tell you the rest of the story. What we're here to tell you is what we find is consistent with the FCC TRO findings. There are provisioning delays. There are service outages -- (audio interruption) -- that result in customer dissatisfaction. The process that was used --

COMMISSIONER JABER: Just in case you all were wondering, that was not me.

(Laughter.)

WITNESS VAN DE WATER: The process that was used three years ago --

COMMISSIONER BRADLEY: I think that's my neighbor.

COMMISSIONER JABER: That's what it is.

WITNESS VAN DE WATER: -- is the same process that's used today. Now, as I've mentioned, I have facilitated numerous hot cut and CLEC facility tours around the country. AT&T began these tours to show staff and others that were interested what it really takes for a CLEC to be in a facilities-based business today. It's not just a hot cut. There's a lot more involved. We had such a -- so many people

wanted other people to go on it, we couldn't do it all, so we decided to produce a video. This is what you're going to see now, a video of the hot cut as well as facilities and some alternatives. Now.

(Hot Cut Video Shown.)

WITNESS VAN DE WATER: Just so everybody understands, the phone number doesn't change under that ELP scenario. That was only as an example. I have been questioned about that. Now that we've have our virtual tour of what it takes in a facility-based business today, I'd like Mr. Nilson to now show what's going on in his business with the UNE loop activity.

WITNESS NILSON: Thank you. Supra Telecom is the only CLEC focussing exclusively on mass market customers. Since we began business in 1997, we have acquired over 300,000 access lines and provide ubiquitous service using UNE-P throughout Florida. When you look at Mr. Gillan's graphs to show the distribution of CLEC customers in Florida, half of those graphs represent Supra Telecom customers.

We're committing to deploying service to our customers using our own network. This allows us to ensure more timely billing records, it gives us full control of intercarrier billing data, and most importantly, UNE-L is preferable to BellSouth UNE-P where sufficient customer volume makes it cost-effective.

How do you determine what that customer volume is?

In Paragraph 484 of the TRO, BellSouth data itself said that for wire centers under 5,000 lines, a competitor would likely experience a net loss. Despite Supra's size and the fact that we serve customers in virtually every BellSouth office in Florida, 85 percent of the offices serving Supra customers contain 5,000 customers or less.

Supra embraced the FCC's three-pronged entry strategy as documented in the First Report and Order, entering the market as a reseller, building market share using UNE-P, and then deployed a network and began cutting customers over. The implementation and roadblocks proved a slightly different story. We applied for collocation in 18 central offices in April of 1998 but finally took possession of these spaces in March of 2002, over five years later. After five years of delays and having litigated this matter seven different times, it has become apparent that the delays benefit the ILEC far more than any penalties which can be levied against them.

Similarly, when Supra initially began its efforts as a reseller, it encountered numerous problems. It took years to resolve those problems. And consistent with the three-pronged entry strategy, Supra then attempted to transition to becoming a UNE-P provider. Both BellSouth and Sprint delayed and fought such implementations. Another five years later, Supra and other CLECs in Florida finally received UNE-P and began to achieve some success. A scant 18 months later, BellSouth seeks

to take it all away claiming that they do not seek a competitive advantage but that the costs they were awarded were too low. Surprisingly, Sprint intends to continue to offer UNE-P at the rates awarded by this Commission.

BellSouth attempts to discredit the CLECs for taking what BellSouth considered to be inconsistent positions. In this forum before this Commission, BellSouth claims Supra to be a qualifying trigger candidate. Paragraph 500 of the TRO states that the key consideration to be examined by state commissions is whether the providers are currently offering and able to provide service and, and I emphasize, are likely to continue to do so. However, as recently as last week in front of the bankruptcy court presiding over Supra's case, BellSouth attacked Supra's, quote, questionable business model and states that, quote, Supra simply cannot hope to sustain itself on its present course. Therefore, BellSouth should not have considered Supra as a qualifying trigger candidate as it is in BellSouth's opinion unlikely to continue to provide service.

State commissions must approve a batch hot cut process according to Paragraph 460 of the TRO. BellSouth in its presentation quoted Paragraph 460 and told the Commission it must approve and implement a batch hot cut process. Well, BellSouth failed to complete the quotation and informed this Commission of the further obligation to reduce the cost of the per-line hot cut process. The FCC found a national impairment

based on several issues, the nonrecurring cost of hot cuts, the potential for disruption of services, and a finding that, in the FCC's opinion, the ILECs were unable to sustain the volume necessary to perform the hot cuts.

I'm going to address those issues separately. First, regarding the nonrecurring cost of the hot cut. The FCC found that the current rates being charged for hot cut process led to impairment. WorldCom in the proceeding at Paragraph 470 estimated that the national average was $51. It's interesting to know that BellSouth is currently charging Supra a nonrecurring cost of $59.31 per hot cut. Supra is the only carrier which has provided a cost study in this proceeding upon which a rate reduction determination can be made. Despite the testimony that the hot cut involves 2.39 minutes of work at the main distribution frame, BellSouth seeks to be paid for 20 minutes' work for this activity, further inflating the nonrecurring costs by $7.61 for this activity alone. Additionally, BellSouth seeks a larger amount to move a second jumper in the outside plant.

Now, the cost study Supra filed is the very same cost study that BellSouth presented to this Commission in the generic UNE docket with modifications that we proposed eliminate avoided costs. This modified cost study shows that the absolute maximum rate for such a hot cut can be no more than $5.27. When referencing its hot cut process, BellSouth in

its presentation included a slide dividing fact and speculation and asked this Commission which it would rather rely upon. Conspicuously omitted from its presentation was any mention of Supra. Why? Because Supra is the only CLEC with actual experience with BellSouth's hot cut process. If this Commission chooses to rely on facts, as BellSouth suggested, Supra is the only party upon which it can rely.

I'd like to take this time to discuss a few of the factual problems Supra has encountered with BellSouth's hot cut process. Addressing the third issue mentioned in Paragraph 459, the ILEC's ability to handle the volume, I want to talk about the limits on daily hot cuts. Despite BellSouth's testimony that its hot cut process is infinitely scalable, they have for almost a year insisted that Supra limit its orders to no more than 150 orders per office per day, and they control this through due date assignment. Supra's efforts to increase this to 300 loops per day have been unsuccessful, and BellSouth testimony shows that a maximum of 264 loops have been cut in a single day.

Talking about time delays for the batch process. If you turn to the TRO in Paragraph 512 and Footnote 1574 where the FCC said, "We have found on a national basis that the delays and costs associated with loop provisioning, those specifically arising from the hot cut process, impair a requesting carrier's entry into the mass market." BellSouth

tells you that no CLEC is using its batch process. What they don't tell you is that Supra and BellSouth working jointly have not been able to get it to work properly and when employed massive fallout of orders has occurred. The only way that Supra was able to convert 13,000 loops in a single month was to resort to the individual LSR process.

BellSouth also does not tell you that recently they have ceased performing the preordering portion of the batch process claiming, at least to Supra, that it was done once as a courtesy and that it simply takes too much time. Supra will have to wait until orders are rejected to find out if a given loop can be converted at all or whether there would be a requirement for Supra to purchase a more expensive SL2 loop. And last of all, they did not tell you that when batch process is used, there is no discount. Supra is billed at the same rate for batch process or for individual hot cuts, and they don't tell you that the batch process adds an additional 14 days to the process ensuring that customer dissatisfaction with the CLEC's ability to rapidly convert the customer becomes a problem.

There are delays in providing go-ahead notices. This is discussed in Paragraph 467 of the TRO. If performed properly, when UNE-P local switching is disconnected and the loop connected to the CLEC's switch, the customer can make an outgoing telephone call but cannot receive one as all the

incoming calls are still being directed to the ILEC's switch until the number is ported. Despite Mr. Ainsworth's testimony about early ports, it is impossible for a CLEC to port the number until BellSouth actually releases the CLEC request to port. This is done as part of the go-ahead process. Therefore, until the CLEC receives a go-ahead notice from BellSouth, the customer is left without incoming call capabilities for an indeterminate period of time, which we found can last as long as five days. In fact, on Monday, November 24, 2003, BellSouth converted 430 Supra loops but delivered only 220 go-ahead notices. Eighty-five more were delivered the following day, on Tuesday, and the remainder trickled in on Wednesday, Thursday, Friday, and Saturday leaving customers without the ability to receive incoming calls during this time period.

Integrated digital loop carrier deployment throughout the network caused further problems. The ILECs would have you believe that the hot cut process is a simple two-minute jumper move in the central office. The reality of the situation is that nearly 70 percent of the loops in south Florida never make it to the central office. They're terminated to integrated digital loop carrier equipment located in remote terminals in the outside plant and brought back to the central office on fiberoptic cable. While various electronic means exist to route that call from the ILEC's switch to the CLEC's switch

using AT&T's proposal, or according to BellSouth proposals, virtual terminal technology or DACS door technologies which we documented in our responses to staff interrogatories, BellSouth has steadfastly refused to implement these technologies in Florida, although it is our belief they have been required to do so in Kentucky as evidenced by the SGAT in that state. Instead, BellSouth insists on completely rebuilding the customer loop using outdated 1960s technology called universal digital loop carrier which digitizes the loop in the outside plant, brings it back to the central office on fiber, and then recreates it back to loop in the central office.

Unfortunately, as Dr. Bryant alluded to in his testimony, the sampling frequency of this older equipment which BellSouth no longer uses to serve its own customers is much too low to allow 56K, 33K, or even 28K modem service to operate. Dr. Bryant told you that this type of technology will potentially cause customer complaints. I'm here to tell you that you need to look no farther than the Commission's consumer affairs department to see the number of complaints over the past five months from Supra customers who have been converted to Supra's network and are now making complaints to this Commission that their modem speed is not what it was under UNE-P.

The second item in Paragraph 459 talks about customer outages and service disruptions, and it's further discussed at

Paragraph 465. BellSouth's insistence on using universal digital loop carrier to rebuild the customer's loop leads to increased instances of outages and service interruptions as errors in LFACS and other outside plant databases cause technicians to build loops to our customers which ultimately have no continuity to the customer premise at the time of the cut. Yet Mr. Varner testifies that BellSouth is perfect in this regard. How is this possible? Quite simply, once BellSouth cuts a loop, they consider the process completed, whether it works on not. Any post-cut anomalies are simply categorized repair issues, not cut failures.

During Mr. Varner's perfect time period, December 17, 2003 through February 11, 2004, Supra issued 628 trouble tickets for no dial tone, no incoming calls and other anomalies. Eighty-four percent of those tickets were caused by and ultimately repaired by BellSouth, each requiring an additional dispatch of a BellSouth technician to repair a hot cut error. Thirty-seven percent took two additional dispatches, 11 percent took three, and 2 percent took an outstanding four additional dispatches beyond the original hot cut to resolve, leaving the customer without working telephone service during the restoration process which in many cases ran as long as five days. Yet despite this and BellSouth's contractual obligation to repair problems on its side of the network interface devise at its own cost, BellSouth continues

to bill Supra from $80 to $150 per call for the above service calls further raising the cost of hot cuts in unseen ways.

The impact of a finding of no impairment. Supra's network currently has a capacity of 28,000 lines. That represents four-tenths of 1 percent of BellSouth's 6.3 million lines in Florida. It's not realistic to assume that a market penetration of four-tenths of a percent is sufficient to deny an entire industry the ability to compete via UNE-P. Supra's expanding its network at the fastest rate it can but lacks the finances necessary to convert completely to UNE-L within the time frames allowed by the FCC. Furthermore, in order to serve customers where we can't deploy equipment would take the provisioning of DS0 EELs. Yet BellSouth does not have the ability to provision upwards of 20,000 DS0 EELs per month which was the rate at which we were able to convert customers under UNE-P. This means that the expansion and the competition that was enjoyed under UNE-P and the growth will not be sustained under UNE-L.

Paragraph 519 of the TRO says, and footnote at 1586, it says that state commissions must ensure that a facilities-based competitor could economically serve all customers in the market before finding no impairment. And the footnote says, "In determining whether impairment exists in a market including a particular group of customers, the typical revenue to be obtained from all customers in that group must be

considered, to ensure that an entering competitor will be able to serve all customers." UNE-P has served as the bridge between full facilities deployment and not serving customers at all. In considering a finding of no impairment, this Commission clearly must consider what will fill the gap in the absence of this bridge. Unless UNE-P is preserved, the competition envisioned by Congress, which is just beginning to be realized, will be reversed as many CLECs will be unable to cross the bridge allowing them to obtain critical mass necessary to efficiently transition to facilities-based competition. Thank you.

WITNESS LICHTENBERG: Good afternoon, Commissioners. I think it's almost good evening. My name is Sherry Lichtenberg. I think most of you notice that that name was plastered all over BellSouth's presentation on Tuesday. I kind of felt like I was Martha Stewart, but I do want to let you know, I cannot weave a blanket out of jumper wires. I do, however, know a lot about operational support systems, about the processes that CLECs use to support customers, about the ways in which orders go through systems, and about the problems that arise as you begin to make those systems changes in order to create a new service delivery method.

I came to MCI in 1997 to try to get us into the local market in UNE loops. It didn't work. We are a UNE-P carrier. We have over 100,000 customers here in Florida. We've worked

very hard. Indeed, I've spoken with you all numerous times in numerous proceedings to talk about the defect levels in the software that BellSouth has created when we've tried to go to new OSS systems, defects that only now are getting fixed because your Commission ensured that BellSouth had a metric for them.

I've talked to you about what we needed for local competition, migrate by name and telephone number so that orders didn't reject right away, and I've talked to you about how difficult it is to develop software and serve customers.

Our UNE-P experience is relevant because much of what BellSouth is proposing here is to recreate the process that we used to move into UNE-P and that took time and that had impact on customers.

The most important point to remember is that BellSouth's hot cut process, as we just heard from Mr. Nilson and as we saw in the video, is the same manual provisioning process it's always had in place. But this process is supposed to deal now with mass market's consumers, and just to make sure that we're focussing together on what we've heard today about what this decision will mean, let's talk for a second about those consumers. They move frequently from carrier to carrier. And in a hot cut world, in a world where those customers are served by UNE loops, there will be a hot cut to come and a hot cut to go regardless of whose network you're coming to or

leaving from. They need their transactions to be seamless and trouble-free. And if you look at the residential consumer primarily served by MCI, they need to be able to have that service work without their intervention because they depend on their telephones for their day-to-day needs and even their personal safety.

BellSouth has no mass markets UNE-L track record. They complete fewer than 2,700 UNE-L orders per month. That's compared to 150,000 UNE-P migrations. They speculate that they can cut 347,150 lines per month. They have actually done 19,029. That was the largest month ever. And they project that they can do 15,567 hot cuts per day. That would make a lot of blankets. In reality, they typically handle only 8,600 cut-overs per month. The systems are manual. Orders fallout for manual handling. And we saw in the UNE-P world that when an order falls to manual, errors can be made, and those errors impact real customers. Mr. Nilson has talked to you about that. UNE-P flow-through rates are much higher, and that's because we've worked together collaboratively with testing to make sure that we could make the process work. But hot cuts are manual and we acknowledge that every loop has to be picked up, lifted and laid back down by a technician and a UNE-P migration takes longer.

Now, BellSouth has promised a number of improvements. They promised a Web-based notification tool in June. They

promised that we can get these DS0 EELs that we need to serve customers where we are not collocated so that we can remote our traffic back to our switches in July 2004. They have offered a Web-based scheduling system that they say is similar to Verizon's WPTS in October 2004. And Mr. Ainsworth said that CLEC UNE loop to CLEC UNE loop migrations can be automated when the system's resources are available. We need these promises completed now because only when we are able to communicate with each other, collaborate with each other, and work together, rather than learning about systems changes in proceedings like this, will we really be able to have UNE-L competition come to fruition.

WITNESS VAN DE WATER: Facts versus promises. A couple of days ago we saw a lot about facts versus speculation, the CLEC speculation. That's facts for us; that's not speculation. I'd like to discuss a little bit more about the promises Ms. Lichtenberg talked about. BellSouth suggests that the criticism of its batch hot cut process is not based on facts. Yet their batch provisioning process is the same as their manual process. We have promises for OSS changes and promises to have new types of orders included in with it. The FCC found that hot cuts caused impairment. That's not a speculation.

Fact: The FCC finding said the evidence indicates that nonrecurring costs associated with cutting over large

volumes of loops would likely be prohibitively expensive.

Promise: BellSouth says the hot cuts will be affordable.

Fact: The process works with limited hot cut volumes today.

Promise: The performance is -- it's sufficient for future performance.

Fact: The FCC found that incumbent LEC's promises of future hot cut performance are insufficient to support a Commission finding that the hot cut process does not impair.

BellSouth promises a future performance about their models that haven't been proven. They will hire more people, they will spend more money, and that their manual provisioning process won't crash under the burden.

Fact: The 271 findings do not support a finding here that competitive carriers would not be impaired.

BellSouth says the 271 approvals demonstrate that they can do the job.

Fact: There are generally no performance intervals, and incumbent LECs are not subject to financial penalties.

Promise: Current standards of penalties will ensure performance.

CLEC response to ILEC batch offerings with Verizon and BellSouth is at this time unusable, vague promises/inadequate improvements. Some of the improvements

BellSouth has is timely restorable service makes no time commitments. The Web-based communications tool, DSL is not included and it's for the embedded base only.

BellSouth mentioned that we would be referring to Footnote 1574 which discusses the fact that this review is necessary to ensure that customer loops can be transferred from the incumbent LEC MDF, or the main distribution frame, to a competitive LEC collocation as promptly and efficiently as incumbent LECs can transfer customers using unbundled local circuit switching. They alluded to the fact that we would not use Paragraph 512. We'll talk about 512. The FCC found on a national basis that the delays and costs associated with loop provisioning, those specifically arising from the hot cut process, impair a requesting carrier's entry into the mass market. The FCC found and have directed the state commissions to implement batch cut processes to reduce the economic and operational barriers posed by the present hot cut process. It doesn't talk about embedded base, it talks an improvement of the current hot cut process. It doesn't rule out retail to the UNE loop. It doesn't rule out anything. It's an improvement to the current process.

They recognized even that after such processes are implemented, competitive carriers still may face barriers associated with the loop provisioning process, even problems arising from the newly improved batch hot cut process. We want

an improved hot cut process. But it still could be workable. It's something that doesn't need to be in concrete during these proceedings. The FCC, therefore, asked the state commissions to consider more granular evidence concerning the ILEC's ability to transfer loops in a timely and reliable manner.

And in conclusion, CLECs do have an incentive to use their own facilities when and where it makes sense. Entry barriers, such as the highly manual process, the service outages, the problems that customers experience today with the current hot cut process, is not something that can be taken lightly. We are asking the Commission to help the CLECs in the collaborative with BellSouth to come up with the best process for UNE loop migrations that we can come up with. A better process will allow competition and customer satisfaction to flourish in Florida. Thank you.

MR. MAGNESS: Commissioners, that concludes the operational panel. We've got approximately 30 minutes left.

CHAIRMAN BAEZ: Let's take a five-minute break.

COMMISSIONER BRADLEY: Mr. Chair.

CHAIRMAN BAEZ: Commissioner Bradley.

COMMISSIONER BRADLEY: Yes. When are you going to entertain questions? I have one short question. I could wait until after the break though.

MR. MAGNESS: I thought when we concluded, any of the witnesses are all still available, and we could bring anybody

up for questions.

CHAIRMAN BAEZ: Commissioner Bradley, did you get that?

COMMISSIONER BRADLEY: No.

CHAIRMAN BAEZ: We've got -- did you say it's about a half an hour more?

MR. MAGNESS: Yes.

CHAIRMAN BAEZ: We've got half an hour more before the direct case is done, and you can ask -- all the witnesses are still going to be in the room, so if you can hold your questions until then.

COMMISSIONER BRADLEY: That's fine.

CHAIRMAN BAEZ: Okay. Thank you.

(Brief recess.)

(Transcript follows in sequence with Volume 26.)

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STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
COUNTY OF LEON)

I, TRICIA DeMARTE, RPR, Official Commission Reporter, 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' attorneys or counsel connected with the action, nor am I financially interested in the action.

DATED THIS 2nd DAY OF MARCH, 2004.

Tricia DeMarte

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