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E. GARY EARLY

January 30, 1998

Ms. Blanca Bayo
Director, Records & Reporting
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0850

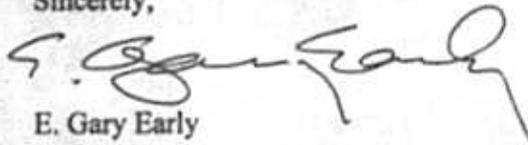
RE: PSC Docket No. 971056-TX

Dear Ms. Bayo:

On behalf of BellSouth BSE, Inc. enclosed for filing in the above referenced docket are the original and fifteen (15) copies of the Notice of Filing Testimony of Robert C. Scheye.

If you have any questions please call me at (850) 222-3471. Thank you.

Sincerely,


E. Gary Early

ACK _____

AFA 1 _____

APP _____

CAF _____ EGE/mcd

CMU 1 _____ enclosure(s)

CTR _____ cc: All parties of record

EAG _____

LEG 2 _____

LIN Strong _____

GPC _____

PHH _____

SEC 1 _____

WAS _____

OTH _____

FORT LAUDERDALE

MIAMI

ORLANDO

TALLAHASSEE

DOCUMENT NUMBER-DATE

01627 JAN 30 88

FPSC-RECORDS/REPORTING

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In Re: Application for certificate to
provide alternative local exchange
telecommunications service by
BellSouth BSE, Inc.

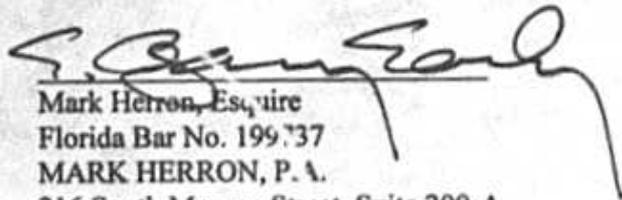
Docket No. 971056-TX

Filed: January 30, 1998

**BELLSOUTH BSE, INC.'S NOTICE OF
FILING TESTIMONY OF ROBERT C. SCHEYE**

Pursuant to the Order Establishing Procedure entered in the above styled proceeding, BellSouth BSE, Inc., through undersigned counsel, files this Notice of Filing the attached testimony of Robert C. Scheye, and the exhibit referenced therein, on this 30th day of January, 1998.

Respectfully Submitted,



Mark Herron, Esquire
Florida Bar No. 199737
MARK HERRON, P. A.
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(850) 567-4878

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Florida Bar No. 325147
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(850) 222-3471

Attorneys for BellSouth BSE, Inc.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that a copy of the foregoing NOTICE OF FILING TESTIMONY OF ROBERT C. SCHEYE was furnished to the following parties by United States mail or hand delivery this 30th day of January, 1998:

By Hand Delivery to:

Martha Carter Brown
Division of Legal Services
Florida Public Service Commission
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Tallahassee, FL 32399-0850

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Counsel for BellSouth Telecommunications, Inc.

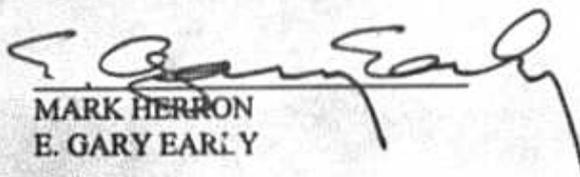
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MARK HERRON
E. GARY EARLY

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BELLSOUTH BSE, INC.
TESTIMONY OF ROBERT C. SCHEYE
BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 97-1056

Q. PLEASE STATE YOUR NAME AND ADDRESS.

A. My name is Robert C. Scheye and my business address is 2727 Paces Ferry Road, Suite 1100, Atlanta, Georgia 30339.

Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED

A. I am employed as Vice President, Supplier Development and Business Relations for BellSouth BSE, Inc. ("BSE").

Q. PLEASE GIVE A BRIEF DESCRIPTION OF YOUR BACKGROUND AND EXPERIENCE.

A. I have thirty years experience in the telecommunications industry, of which ten years has been with BellSouth. Prior to that I worked with AT&T and C&P Telephone Companies (now part of Bell Atlantic). During that period of time I have held several regulatory and planning positions. Most recently, I have been involved in BellSouth meeting its responsibilities under the Telecommunications Act of 1996. My prior responsibilities included the development of access charges in accordance with the Modification of Final Judgment.

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

2

3 A. The purpose of my testimony is to support the application of BellSouth BSE, Inc. for an
4 alternate local exchange carrier (ALEC) certificate to provide service in the state of Florida.
5 BSE filed an application for certification as an ALEC in the state of Florida on August 15,
6 1997. Upon Staff recommendation, the Commission voted unanimously to approve the
7 certificate in the Regular Agenda session on October 7, 1997. On November 17, 1997 MCI
8 and the FCCA filed protests. At the January 7, 1998 Staff Workshop for issues
9 identification, it was decided that the scope of these proceedings would be limited to two
10 issues: 1. Should the Commission grant BSE a statewide ALEC certificate and, 2. If the
11 Commission grants BSE a statewide certificate, should the Commission impose conditions
12 or obligations not imposed on other ALECs. I will address the two issues identified in that
13 workshop.

14

15 Q. IN LIGHT OF THE PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996
16 AND CHAPTER 364, SHOULD THE COMMISSION GRANT BELLSOUTH BSE A
17 CERTIFICATE TO PROVIDE ALTERNATIVE LOCAL EXCHANGE SERVICE
18 PURSUANT TO SECTIONS 364.335 AND 364.317, FLORIDA STATUTES, IN THE
19 TERRITORY SERVED BY BELLSOUTH TELECOMMUNICATIONS, INC. AS THE
20 INCUMBENT LEC?

21

22 A. Yes. FLA. STAT. Ch. 364.337 (1) states, "The commission shall grant a certificate
23 of authority to provide alternative local exchange service upon a showing that the applicant
24 has sufficient technical, financial and managerial capability to provide such service in the
25 geographic area proposed to be served.... It is the intent of the Legislature that the

1 commission act expeditiously to grant certificates of authority under this section and that
2 the grant of certificates not be affected by the application of any criteria other than that
3 specifically enumerated in this subsection." (emphasis added). Obviously since the
4 protesters are not protesting BSE be granted a certificate to provide alternative local
5 exchange service outside BellSouth Telecommunications service area, they admit that BSE
6 has sufficient technical, financial and managerial capability to provide the service. Since
7 that is the sole criteria outlined in the statutes on which the decision is to be based, the
8 Commission should grant the certificate for the entire geographic area proposed to be
9 served.

10
11 In addition, the 1996 Act specifically addresses the situation when a company that is an
12 affiliate of an ILEC provides local exchange service in the same serving territory as the
13 ILEC. Section 272 (e) states that the ILEC must "fulfill any requests from an unaffiliated
14 entity for telephone exchange service and exchange access within a period no longer than
15 the period in which it provides such ...[services]... to itself or to its affiliates." (emphasis
16 added). Further, Section 272(g) clearly permits the affiliate of a BOC to provide
17 telephone exchange services if the BOC permits other entities to market and sell its
18 services as well. Obviously, if the 1996 Act did not contemplate that such activity might
19 take place, there would have been no need to adopt such provisions.

20
21 Q. IS THERE A PRECEDENT OF ALECS AFFILIATED WITH AN ILEC BEING
22 GRANTED AUTHORITY TO PROVIDE LOCAL EXCHANGE SERVICE IN THE
23 SERVING TERRITORY OF ITS AFFILIATED ILEC?
24
25

1 A. Yes. Many companies which own ILECs have established affiliated CLECs. A quick
2 analysis indicates that Sprint, GTE, Ameritech and Southern New England Telephone
3 ("SNET") all have established CLECs. Exhibit 1 to this testimony summarizes those
4 states where CLECs that are affiliates of ILECs have been granted a certificate in the
5 territory served by the ILEC. In every case where the circumstances were similar to
6 BSE's request here in Florida, the certificate has been granted.

7

8 In Florida, Order No. PSC-97-0222-FOF-TX issued February 24, 1997, GTE Card
9 Services Inc. d/b/a GTE Long Distance Inc. was granted authority to provide alternative
10 local exchange telecommunications services statewide. Prior to that, Order No. PSC-95-
11 1602-FOF-TX issued December 27, 1995 granted Sprint Metropolitan Networks
12 statewide authority to provide alternative local exchange telecommunications services.
13 The order states, "Section 364.337(1), Florida Statutes, requires us to grant a certificate to
14 provided alternative local exchange telecommunications service upon a showing that the
15 applicant has sufficient technical, financial, and managerial capability to provide such
16 service in the geographic area proposed to be served." (emphasis added).

17

18 After hearing all parties, the South Carolina Commission issued Order No. 97-1063,
19 dated December 23, 1997 (attached as Exhibit 2) granting BSE a certificate to provide
20 local service. In summary, the South Carolina Commission found that granting the
21 certificate "will not adversely impact the availability of affordable local exchange
22 service" and "does not otherwise adversely impact the public interest". In response to
23 MCI's argument that as an affiliate of an ILEC, BSE could not provide local service in
24 BST's territory, the Order simply states: "We disagree." MCI filed a Petition for
25 Rehearing or Reconsideration which the Commission Dismissed on January 27, 1998.

1 Additionally, on January 5, 1998 the administrative law judge that conducted the BSE
2 certification hearing in Alabama recommended that BSE's certificate be granted.

3
4 Q. **HAVE ANY CERTIFICATES BEEN GRANTED WITH LIMITATIONS?**

5
6 A. Exhibit 1 summarizes twenty-one instances where ALECs have been approved in the
7 territory served by their affiliated ILEC. There have only been two instances in the
8 nation (GTE in Texas and GTE in Michigan) that the Commission placed limitations on
9 the ALEC certificate. The limitations were based on situations not existent in Florida.

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11 Q. **IN LIGHT OF THE PROVISIONS OF THE TELECOMMUNICATIONS ACT OF 1996
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14 THE TERRITORY SERVED BY BELLSOUTH TELECOMMUNICATIONS, INC. AS
15 THE INCUMBENT LEC, WHAT CONDITIONS OR OBLIGATIONS, IF ANY,
16 SHOULD THE COMMISSION IMPOSE?**

17
18 A. BellSouth BSE should be allowed to operate under the same conditions or obligations as
19 all other ALECs in the state of Florida. The Rules of the Florida Public Service
20 Commission, Chapter 25-24, Part - XV, "Rules Governing Telecommunications Service
21 Provided by Alternative Local Exchange Companies" provide the conditions under which
22 an ALEC may operate in the state of Florida.

23
24 The Florida Statutes, Chapter 364.337 (5) states, "The commission shall have continuing
25 regulatory oversight over the provision of basic local exchange telecommunications

1 service provided by a certificated alternative local exchange telecommunications
2 company...for purposes of establishing reasonable service quality criteria, assuring
3 resolution of service complaints, and ensuring the fair treatment of all
4 telecommunications providers in the telecommunications marketplace." Clearly the
5 Commission has the responsibility and the authority to insure against any potential harm
6 to competition or to customers that might occur. Therefore, additional conditions on
7 BSE's certification are not needed.

8
9 The provisions of the 1996 Act and the regulations adopted by the FCC provide
10 additional safeguards. Sections 251 and 252 of the 1996 Act require the ILEC to treat all
11 CLECs on a nondiscriminatory basis. These provisions ensure that BellSouth
12 Telecommunications cannot provide any advantage in the marketplace to BellSouth BSE.
13 The arguments made by intervenors to this Commission that BellSouth BSE might
14 engage in discrimination or cross-subsidy were also presented to the FCC. The FCC
15 found these arguments to be "speculative" and "non-persuasive." FCC Order No. 96-149
16 at para. 314. The FCC concluded "In sum, we find no basis in the record for concluding
17 that competition in the local market would be harmed if a Section 272 affiliate offers
18 local exchange service to the public that is similar to local exchange service offered by
19 the BOC." FCC Order No. 96-149 at para. 315. Additionally, the FCC wrote that the
20 "increased flexibility resulting from the ability to provide both interLATA and local
21 services from the same entity serves the public interest" by encouraging such an affiliate
22 to "provide innovative new services." Id.

23
24 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

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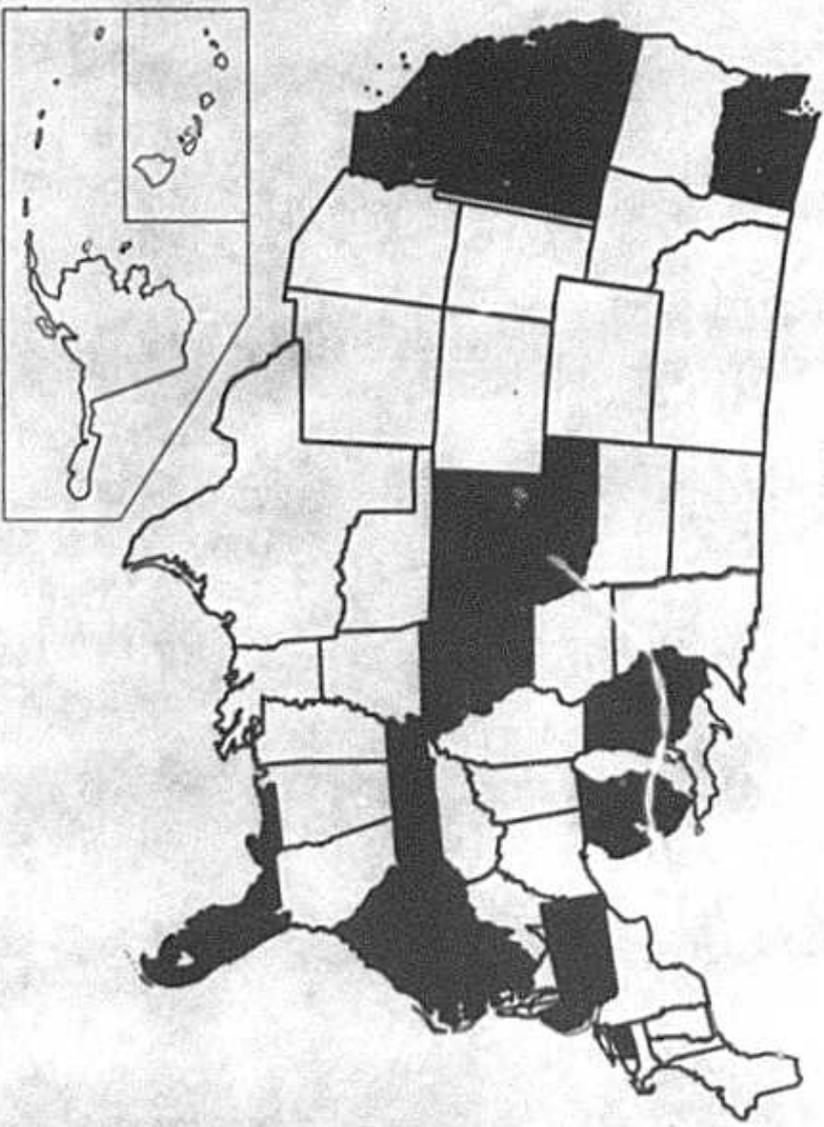
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CLECs Approved in Affiliate's ILEC Territory

California	GTE	Approved	12/30/95 & 2/23/96
Connecticut	SNET	Approved	6/25/97
Florida	BELLSOUTH	*Approved	10/27/97
Florida	GTE	Approved	2/24/97
Florida	SPRINT	Approved	12/28/95
Kansas	SPRINT	Approved	8/7/96
Michigan	AMERITECH	Approved	8/28/96
Missouri	Sprint	Approved	2/28/97
Nebraska	SPRINT	Approved	3/10/97
Nevada	SPRINT	Approved	11/17/97
New Jersey	SPRINT	Approved	7/17/96
North Carolina	GTE	Approved	4/16/97
North Carolina	SPRINT	Approved	3/24/97
Pennsylvania	SPRINT	Approved	
South Carolina	GTE	Approved	9/12/97
South Carolina	SPRINT	Approved	12/3/96
South Carolina	BELLSOUTH	Approved	12/23/97
Tennessee	SPRINT	Approved	10/3/96
Virginia	SPRINT	Approved	11/8/96
Washington	SPRINT	Approved	7/9/97
Wisconsin	AMERITECH	Approved	11/26/96

* Approved by PSC, protests filed.

CLECs Approved in Affiliate's ILEC Territory



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BELLSOUTH BSE, INC.

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FPSC REGULATORY DIVISION

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18 **A. BellSouth BSE should be allowed to operate under the same conditions or obligations as**
19 **all other ALECs in the state of Florida. The Rules of the Florida Public Service**
20 **Commission, Chapter 25-24, Part - XV, "Rules Governing Telecommunications Service**
21 **Provided by Alternative Local Exchange Companies" provide the conditions under which**
22 **an ALEC may operate in the state of Florida.**

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24 The Florida Statutes, Chapter 364.337 (5) states, "The commission shall have continuing
25 regulatory oversight over the provision of basic local exchange telecommunications

1 service provided by a certificated alternative local exchange telecommunications
2 company...for purposes of establishing reasonable service quality criteria, assuring
3 resolution of service complaints, and ensuring the fair treatment of all
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5 Commission has the responsibility and the authority to insure against any potential harm
6 to competition or to customers that might occur. Therefore, additional conditions on
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10 additional safeguards. Sections 251 and 252 of the 1996 Act require the ILEC to treat all
11 CLECs on a nondiscriminatory basis. These provisions ensure that BellSouth
12 Telecommunications cannot provide any advantage in the marketplace to BellSouth BSE.
13 The arguments made by intervenors to this Commission that BellSouth BSE might
14 engage in discrimination or cross-subsidy were also presented to the FCC. The FCC
15 found these arguments to be "speculative" and "non-persuasive." FCC Order No. 96-149
16 at para. 314. The FCC concluded "In sum, we find no basis in the record for concluding
17 that competition in the local market would be harmed if a Section 272 affiliate offers
18 local exchange service to the public that is similar to local exchange service offered by
19 the BOC." FCC Order No. 96-149 at para. 315. Additionally, the FCC wrote that the
20 "increased flexibility resulting from the ability to provide both interLATA and local
21 services from the same entity serves the public interest" by encouraging such an affiliate
22 to "provide innovative new services." Id.

23
24 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

25

1 A. Yes.

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1 BY MR. EARLY:

2 Q Mr. Scheye, would you please briefly
3 summarize your testimony for the Commission?

4 A Today we're here to discuss BellSouth BSE's
5 request for certification in the state of Florida.

6 COMMISSIONER CLARK: Are we doing just
7 direct or direct and rebuttal?

8 MR. EARLY: Direct. Rebuttal will go later?
9 Is that okay?

10 COMMISSIONER CLARK: It's okay with me. Let
11 me just ask a question. On Page 10, Line 18,
12 shouldn't "amble" be "ample"?

13 WITNESS SCHEYE: I'm sorry. Page?

14 COMMISSIONER JACOBS: Page 10, Line 18. I'm
15 sorry. I'm on your rebuttal.

16 WITNESS SCHEYE: I don't have ten pages. Is
17 that rebuttal? I will check that before I come back
18 up.

19 COMMISSIONER CLARK: And we're only doing
20 direct.

21 WITNESS SCHEYE: I'm only doing direct.
22 Correct. Therefore, I'll even be briefer.

23 BellSouth BSE's intent is to bring new and
24 innovative services to the state of Florida, to both
25 residence and business customers. That's the basic

1 reason that we are requesting certification here
2 today. We believe in doing so we will do so in accord
3 with all FCC rules, this Commission's rules and
4 totally consistent with the Telecommunications Act of
5 1996.

6 Our request is not unique. Around the
7 country 21 cases similar to ours have been approved by
8 commissions. This Commission has approved Sprint in
9 the state of Florida to operate both within and beyond
10 its territory. BellSouth BSE is currently certified
11 within three states within the nine Bell regions, as
12 well as many states outside.

13 Clearly, the Act and the FCC rules envision
14 affiliates providing services such as ours. As a
15 matter of fact, the FCC rules in considering this
16 issue said, one, it would benefit the public interest
17 because affiliates such as ours would bring new and
18 innovative services to the individual states. That's
19 what we're about. That's what we're attempting to do.
20 For residence, we will provide fully integrated
21 services, packages, and for businesses, multi-state
22 capability within the state of Florida and beyond.
23 Right now we've filed for certification in 21 states.
24 Nine BellSouth states, and 11 or 12 outside the
25 region, and we're planning to do more.

1 **COMMISSIONER DEASON:** Say that again. You
2 said you all have filed --

3 **WITNESS SCHEYE:** We have filed for
4 certification in 21 states. We're approved right now
5 in 12. And the other ones are still pending, I
6 believe.

7 **COMMISSIONER GARCIA:** Those three are --

8 **WITNESS SCHEYE:** Three of those are --

9 **COMMISSIONER GARCIA:** Southern states.

10 **WITNESS SCHEYE:** Southern states. South
11 Carolina, Alabama, Georgia right now.

12 **COMMISSIONER DEASON:** Alabama. Is that
13 recently? It wasn't on your list here, in your
14 exhibit. Alabama was not. Was it?

15 **WITNESS SCHEYE:** I believe it was. Again, I
16 believe that's attached to rebuttal testimony.

17 **COMMISSIONER DEASON:** No. This is attached
18 to the direct. And I heard you say earlier that you
19 all had been approved in three states. And I was
20 assuming that was Florida, South Carolina, and you
21 said the third is Alabama? Am I confusing something?

22 **WITNESS SCHEYE:** Exhibit 1 to the rebuttal
23 testimony --

24 **MR. EARLY:** Chairman Johnson, in the
25 description of Mr. Scheye's direct examination he

1 indicated that there were some changes that were in
2 his rebuttal. There's an updated map attached to his
3 rebuttal testimony that includes Alabama and Georgia.

4 WITNESS SCHEYE: And it does indicate on, I
5 believe it's February 2nd, that we were approved in
6 Alabama.

7 CHAIRMAN JOHNSON: Got you. Thank you.

8 WITNESS SCHEYE: In essence, all we want to
9 do is provide consumers and businesses another
10 opportunity in the state of Florida with services
11 currently not available to them; not only in the state
12 of Florida but as I said, in at least 20 other states.
13 We believe -- we will be using all the same
14 operational support systems as any other CLEC. We
15 will have no advantage over any other CLEC. We will
16 operate just like any other CLEC. And on that basis,
17 and in addition, we feel we've met all of the
18 requirements of this Commission to be certified. We,
19 therefore, request you approve our certificate so we
20 can begin complete business in the state of Florida.
21 Thank you.

22 MR. EARLY: That concludes our direct
23 examination of Mr. Scheye.

24 CHAIRMAN JOHNSON: Thank you.

25

1 CROSS EXAMINATION

2 BY MR. MCGLOTHLIN:

3 Q Mr. Scheye, I'm Joe McGlothlin. I have only
4 a few questions for you on your direct testimony.5 Is it true, sir, that the management
6 expertise or business expertise of BellSouth BSE is
7 derived from other BellSouth companies?

8 A In part it did, that's correct.

9 Q Is it true that the source of capital for
10 BellSouth BSE is BellSouth Corporation?11 A Yes. Like any other start-up within
12 BellSouth, the corporation has funded us.13 Q Is it true that the same corporation,
14 BellSouth Corporation, is the source of capital for
15 BellSouth Telecommunications, the ILEC?16 A Not exactly the same. BellSouth
17 Telecommunications, of course, is a mature company,
18 and, therefore, derives its own funding. But we are
19 certainly both affiliates of BellSouth Corporation.20 Q BellSouth Telecommunications, the ILEC, has
21 a very familiar logo that it adds to its business
22 undertakings. It's the symbol of a bell with a little
23 circle around it. Has BellSouth BSE determined what
24 logo it's going to use in its operation?

25 A We have not precisely determined the logo we

1 will use, but I can assure you that we intend to use
2 the BellSouth name, like all of the BellSouth
3 affiliates do, and we would include the logo, as you
4 describe it, the circle with the bell inside, just
5 like BellSouth Cellular, BellSouth Publishing,
6 BellSouth Entertainment and eventually BellSouth Long
7 Distance. So I would say we will be using the same
8 sort of logo; that we haven't finalized the marketing
9 name that we will use.

10 Q Will BellSouth BSE attempt to maximize
11 shareholder value in its business undertakings?

12 A Yes, absolutely.

13 Q And who are the shareholders to whom
14 BellSouth BSE will be answerable?

15 A They are the shareholders of BellSouth
16 Corporation.

17 Q Who are the shareholders to which BellSouth
18 Telecommunications the ILEC is answerable?

19 A Again, we're all affiliates of BellSouth
20 Corporation, so, therefore, its the same shareholders
21 and we believe the business that we will go into --

22 Q Excuse me, sir. That answers the question.

23 A That's all right. Can I finish though?

24 Q Well, I think you did.

25 A I just as soon -- I won't interrupt you on

1 your questioning if you won't interrupt me in my
2 answers. Is that okay?

3 Q No, sir, it's not okay if you go beyond the
4 scope of the question.

5 COMMISSIONER DEASON: Hold up. I'm going to
6 allow the witness to begin his answer with a yes or
7 no, and provide explanation where explanation is
8 necessary.

9 In this instance I think the gentlemen was
10 in the middle an of a sentence -- I don't remember
11 what it was now that he was interrupted, but I was
12 following that thought.

13 Let's start over so that the record is
14 clear. You can start with the explanation of your
15 answer.

16 WITNESS SCHEYE: I believe I was trying to
17 conclude that while, yes, there is one set of
18 shareholders, that BellSouth as the corporation --

19 CHAIRMAN JOHNSON: Slow down a little bit.

20 WITNESS SCHEYE: -- that we believe that we
21 will maximize shareholder value by us, BellSouth BSE,
22 being a profitable organization, as well as BST being
23 a profitable organization, and that in that fashion we
24 will maximize shareholder value.

25 Q (By Mr. McGlothlin) Mr. Scheye, do you

1 think that BellSouth Telecommunications, the ILEC,
2 will also attempt to maximize shareholder value"

3 A I would certainly assume so, yes, sir.

4 Q Do you think their shareholders will
5 evaluate the success of BellSouth Corporation's
6 various undertakings on an overall basis?

7 A I can't speak for every shareholder but I
8 think it's a decent assumption that they look at the
9 overall corporation as they would for any other
10 corporation to make their decisions.

11 MR. MCGLOTHLIN: I'm going to distribute a
12 document and ask that a number be assigned to it.

13 CHAIRMAN JOHNSON: I'll identify this as
14 Exhibit 3. You said you wanted it identified,
15 Mr. McGlothlin?

16 COMMISSIONER DEASON: I'll identify it as
17 Exhibit 3 with a short title "Commonwealth of Kentucky
18 Case No. 97-417."

19 (Exhibit 3 marked for identification.)

20 Q (By Mr. McGlothlin) Mr. Scheye, you have
21 been involved in the applications of BellSouth BSE and
22 other states besides Florida, have you not?

23 A Yes.

24 Q You recognize this as a copy of the
25 application that BellSouth BSE filed in the state of

1 Kentucky?

2 A Yes.

3 Q Would you turn to Page 4 and read the first
4 sentence of numbered paragraph 13?

5 A "In sum, certification of the applicant will
6 enable a capable, experienced and financially sound
7 company, with a solid reputation for innovation and
8 quality service to compete on an equal basis in
9 today's increasingly competitive telecommunications
10 environment."

11 Q Is it true that BellSouth BSE, Inc. is a new
12 start-up company?

13 A Yes.

14 Q During the opening statement, your counsel
15 alluded to what would happen -- said in so many words,
16 I believe, that a customer must call BellSouth BSE if
17 it wants to do business with BellSouth BSE and not the
18 ILEC.

19 If you would assume for a moment that it's
20 possible the customer gets temporarily confused and
21 thinking it's calling BellSouth BSE, gets the ILEC
22 instead. What do you think would happen to that call
23 at that point?

24 A I guess, since there's no such procedure, no
25 such scenario, but I would have to assume that if the

1 customer called the incorrect company, and once the
2 service representative, or whomever, determined that
3 they had called the wrong company, they would indicate
4 that to the customer; that they had indeed called the
5 wrong company and suggest that they call the company
6 that they were trying to get.

7 The closest analogy I can get to in today's
8 environment is on repair service. There are
9 potentially instances where a customer of a CLEC, say,
10 goes to his neighbor's house, dials 611 for repair,
11 and that neighbor happens to be a PST customer, and
12 because of that they get BST repair service. At that
13 point the BST repair service, when looking up the
14 line, would find out it's not a BST customer and would
15 indicate that they had called the wrong repair
16 company, or wrong company, and that they needed to
17 notify the correct company.

18 Q Which in this case would be BellSouth BSE?

19 A In today's world it's any other CLEC that's
20 out there, but in tomorrow's world that could be --
21 BSE could be one of those CLECs; that the call had
22 been inadvertently routed to BST.

23 Q So if the call were misdirected, BellSouth,
24 the ILEC, would logically direct them to BSE, correct?

25 A Well, they would logically attempt to help

1 the customer by first indicating that they had called
2 the wrong company. And then to the extent they could,
3 try to direct them to the correct company. Not in
4 every case would they know who the customer is really
5 trying to get to, but they would try to be as helpful
6 as possible to the customer, even though it wasn't
7 their customer.

8 MR. McGLOTHLIN: Those are all the questions
9 I have.

10 CHAIRMAN JOENSON: Mr. Bond.

11 CROSS EXAMINATION

12 BY MR. BOND:

13 Q Good afternoon. Tom Bond on behalf of MCI.

14 A Good afternoon.

15 Q I believe you have already said that
16 BellSouth will market under the BellSouth brand name
17 and use the BellSouth logo; is that correct?

18 A Yes, sir, that's correct.

19 Q Is BSE intending to pay BellSouth for the
20 use of the brand name and logo?

21 A No, sir. In BellSouth Corporation the
22 individual affiliates don't pay directly for the use
23 of the BellSouth name. That's a BellSouth practice.

24 Q And BellSouth Corporation owns all of the
25 stock of BSE; is that correct?

1 A That's correct.

2 Q And BellSouth Corporation owns all of the
3 stock of BST?

4 A Correct.

5 Q Now, is it correct that the president of BSE
6 is an officer of BellSouth Corporation?

7 A I'm sorry, could you repeat that again?

8 Q The president of BSE is an officer of
9 BellSouth Corporation?

10 A Yes.

11 Q Okay.

12 A Of the corporation, not of BST, though.

13 Q Right, not BST.

14 A Just want to be clear.

15 Q Does he sit on the board of BellSouth
16 Corporation?

17 A No.

18 Q Okay. How many employees does BSE currently
19 have?

20 A We have right now less than 20.

21 Q Okay. And of that less than 20, how many
22 are from BellSouth or its various entities?

23 A I usually estimate this -- and if I give you
24 a different number than I gave in Kentucky it's not
25 intentional -- I believe it's about 60 to 70% from

1 other BellSouth companies.

2 Q Okay. And if BSE gets certified in Florida,
3 what sales personnel will you use in Florida?

4 A We have not made that decision yet. That's
5 probably going to be outsourced to some sort of direct
6 mail or calling type company but we've not made that
7 decision.

8 Q Is it possible you would use the sales force
9 of BST?

10 A Not very likely.

11 Q Does BSE have any plans to try to advertise
12 to customers that there's a distinction between BSE
13 and BST?

14 A Yes, in several different ways. One, first
15 and foremost, the product we will offer, the fully
16 integrated package and the multi-state capability,
17 would be differentiated from something that BST
18 offered within the same location. So it would be
19 first differentiated by product. Secondly, the name
20 we go to market with will not be BellSouth
21 Telecommunications, so it will have a different name
22 and will be differentiated on that basis as well.

23 Q But it might be BellSouth or BellSouth
24 Enterprises or BellSouth BSE, something like that?

25 A It wouldn't just be BellSouth. It could be

1 BellSouth BSE. Candidly that's our incorporated name.
2 It doesn't have much of a market ring to it. So we
3 may try to come up with something slightly more
4 inventive.

5 MR. BOND: That's all the questions I have.

6 CROSS EXAMINATION

7 BY MS. RULE:

8 Q Good afternoon, Mr. Scheye. Just a couple
9 of questions.

10 BellSouth Telecommunications currently
11 enters into contract service arrangements, or CSAs,
12 with customers, does it not?

13 A Yes.

14 Q Does BellSouth BSE intend also to enter into
15 CSAs with customers?

16 A No, not of the type you're thinking of. It
17 is possible that for our larger customers, for example
18 a multi-state customer, which would traverse multiple
19 tariffs, or price lists, depending on the state, we
20 may have some sort of contractual arrangement with
21 that customer so that all the different rates and
22 provisions are covered.

23 Each state regulates CLECs a little bit
24 differently. Some states require price lists, some
25 require tariffs. In order to -- if we were doing a

1 five- or ten-state offering, we may also have some
2 sort of contract with that individual customer, but
3 not of a CSA type that you typically are thinking
4 about with BST.

5 Q I'm sorry, I think you started out by saying
6 yes, possibly, and then ended up by saying no,
7 probably not.

8 A Okay. We will not have CSAs of the type
9 that I believe you're referring to with BST. What I
10 was referencing was we are likely to have customers
11 who are in a multi-state environment. Their rates
12 would be covered by either price lists in individual
13 states, or tariffs. In order to fully encompass what
14 that particular customer has purchased from us, we're
15 likely to have some sort of a contract with them.
16 And, again, you might call that a contract service
17 arrangement, and I was trying to simply differentiate
18 that from what BST offers today.

19 Q Let's follow up on that a little bit.

20 Under Florida rules, as I'm sure you know,
21 ALECs are not required to price list all of their
22 offerings, are they?

23 A I believe that's correct.

24 Q So in order to enter into an arrangement
25 with a customer, if that arrangement is not price

1 listed, you would do it via some form of contract,
2 would you not?

3 A Yes. Correct.

4 Q Okay. So let's, just for clarity's sake
5 right now, refer to that arrangement as a contract
6 service arrangement.

7 A Okay.

8 Q With that limited view of what a contract
9 service arrangement is, does BellSouth BSE intend to
10 enter into that type of contractual service
11 arrangement with customers?

12 A With that kind of definition I think
13 certainly it's possible with our large customers, yes.

14 Q So you do intend to enter into individual
15 agreements with customers to offer items that are not
16 strictly price listed, correct?

17 A Yes. Again, let me clarify. Some states
18 have price lists. As you mentioned, Florida. Some
19 other states will have tariffs; may not need it for
20 those states. So it would likely vary.

21 Q I understand. But I'm asking you to limit
22 your answer to Florida.

23 A Sure.

24 Q Okay. Now, BellSouth Telecommunications is
25 required to allow competitors to resell its

1 contractual nontariffed offerings, is it not?

2 A Yes.

3 Q But there's no such requirement imposed on
4 ALECs in Florida to allow the resale of their
5 contractual non-price-list offerings, is there?

6 A I haven't looked at the Florida Statute with
7 that level of precision. I will accept your
8 interpretation.

9 It is my view that all CLECs are required to
10 have all of their services available for resale. I
11 haven't really attempted to make a distinction in my
12 head about something that was an UNE contract versus
13 something that may have been price listed or tariffed,
14 but I will accept your interpretation of the Florida
15 Statute.

16 Q I'm sorry, I'm not sure where that leave us.

17 COMMISSIONER DEASON: Excuse me. Perhaps I
18 misunderstood. I think you said that all CLECs in
19 Florida are required to resell their services.

20 WITNESS SCHEYE: All CLECs are required to
21 resell their telecommunications services under the
22 Act. They are not required to put in an avoided cost
23 discount on it. But resale is required under the Act
24 for all --

25 CHAIRMAN DEASON: But not at a discount.

1 WITNESS SCHEYE: Without a discount. That
2 is correct.

3 Q (By Ms. Rule) BellSouth
4 Telecommunications, on the other hand, is required to
5 resell at a discount, is it not?

6 A I don't recall the provisions in Florida.
7 It may be. Some states require contract service
8 arrangements to be available with a discount and some
9 don't. And I don't honestly recall what the Florida
10 situation is. It may be.

11 Q I think we're mixing federal law and state
12 law, which these days is pretty easy to do. But under
13 the Telecommunications Act, CLECs are not required to
14 resell -- allow resale of CSAs at a discount, are
15 they?

16 A Again, I haven't interpreted the Act or the
17 state statutes as to distinguish services that are
18 price listed versus those that are contracted.

19 My interpretation has been that under the
20 Act, all CLEC services are available for resale
21 without a discount. And I haven't made a distinction
22 on contract service arrangements or contracted
23 arrangements. My assumption is they would be
24 available for resale.

25 Q At a discount or not?

1 A No, not at a discount.

2 Q Okay. Now, on the other hand, if BellSouth
3 Telecommunications were to offer a CSA, it would be
4 available for resale at a discount, would it not?

5 A That's what I was trying to -- I don't
6 recall. In the arbitration proceedings in front of
7 this Commission, as well as all the other commissions,
8 some Commissions ruled that CSAs would be made
9 available by the incumbent at a discount, and others
10 ruled that it would not be available at a discount. I
11 don't remember the Florida decision.

12 Q Would you accept, subject to check, that it
13 would be available at a discount?

14 A Yes.

15 Q Thank you.

16 **MS. RULE:** No further questions.

17 **COMMISSIONER CLARK:** Mr. Scheye, I want to
18 ask you a question. When you say CLECs will be
19 required to sell their service, I think one of the
20 things the petitioners have alleged is you'll buy a
21 service for resale and you'll get the discount, say,
22 for residential service, and then you'll sell less
23 than the wholesale cost.

24 If you did that, would you be required to
25 resell that service to other CLECs at that discounted

1 price?

2 WITNESS SCHEYE: Yes.

3 COMMISSIONER CLARK: Okay.

4 CHAIRMAN JOHNSON: Mr. Ellis.

5 CROSS EXAMINATION

6 BY MR. ELLIS:

7 Q Mr. Scheye, among the integrated packages of
8 services that BellSouth intends to offer, do those
9 include entertainment services?

10 A They may, yes. Might, yes.

11 Q Cellular services?

12 A Yes.

13 Q Internet services?

14 A Yes.

15 Q Would BSE be able to provide entertainment
16 services if it were not able to purchase local
17 exchange service from BellSouth Tel/communications at
18 the avoided cost discount?

19 A I'm sorry. Could it, BSE, provide
20 entertainment services by itself? I'm just not sure
21 of your question, sir.

22 Q Could it provide entertainment services if
23 it were not able to purchase, or permitted to
24 purchase, or certificated to purchase, local exchange
25 service at a wholesale discount from BST?

1 A I guess the answer is technically it could
2 but it wouldn't be a CLEC at that point in time, it
3 would be the provider of an entertainment service and
4 BellSouth already has an affiliate that is the
5 entertainment provider, so I don't believe we would
6 replicate that.

7 Q BellSouth --

8 A BellSouth Entertainment is our entertainment
9 subsidiary, so without a CLEC certificate it wouldn't
10 do us much good --

11 COMMISSIONER GARCIA: Mr. Scheye, what keeps
12 BellSouth from -- excuse me for a second -- what keeps
13 BellSouth from offering these new and innovative
14 services through its LEC?

15 WITNESS SCHEYE: Legally or jurisdictionally
16 probably, with one exception that I mentioned, I
17 think. The exception is long distance services which,
18 of course, are in the future. BST is limited to the
19 joint marketing restrictions as established and yet to
20 be interpreted. We plan to fully integrate long
21 distance into our packages.

22 Secondly, business customers would have a
23 multi-state need, we plan to offer services outside
24 the nine-state region, which is something that BST has
25 not attempted to do. Though, candidly, if BST chose

1 to become certificated in Indiana or Illinois, we
2 could certainly attempt to do so.

3 Conversely, we're looking toward a focus on
4 integration and a focus on multi-state, and that's why
5 we've established a separate company. We believe --
6 again, it's fully in accord with all of the
7 requirements. We will use all of the operational
8 support systems, and, in fact, again using the --

9 **COMMISSIONER GARCIA:** When you use the word
10 "innovative, the word "innovative" for you means to
11 integrate the long distance into the services that are
12 already offered by your LEC.

13 **WITNESS SCHEYE:** As well as possibly
14 entertainment, Internet, paging, those types of
15 things.

16 **COMMISSIONER GARCIA:** Entertainment,
17 Internet and paging, you would probably be -- if I --
18 correct me if I'm wrong -- you can offer through your
19 local.

20 **WITNESS SCHEYE:** Yes, we could package that
21 way, you're correct. Again, the multi-state
22 capability is something else we're looking at somewhat
23 innovative for BellSouth. We typically haven't
24 branched out of our own nine-state area for the
25 provision of local service. That to us is something

1 new and different and hopefully be beneficial to
2 business customers.

3 **COMMISSIONER GARCIA:** So, in essence, this
4 is because of the integration of long distance. What
5 if it worked out? What if this was a good idea and
6 this Commission approved it, you went forward, and it
7 really worked out. Your customers decided to get this
8 service as opposed to your local service? What effect
9 would that have on your life?

10 Let's say 50% of your customers today, local
11 customers, decided to go to BellSouth -- what's the --

12 **WITNESS SCHEYE:** BellSouth BSE.

13 **COMMISSIONER GARCIA:** What would happen to
14 the LEC?

15 **WITNESS SCHEYE:** The LEC would have an
16 increase in its wholesale business because we would be
17 buying at wholesale from them as opposed to them
18 selling retail.

19 **COMMISSIONER GARCIA:** Right.

20 **WITNESS SCHEYE:** Assuming the avoided cost
21 discount is properly set for BST, their financials
22 have not changed one cent. In other words, their
23 revenues drop by the amount of the discount; their
24 expenses have presumably dropped proportionately
25 because of the avoided cost discount, so BST is

1 financially no different than it was had we not
2 existed, and the customers simply have another option.

3 **COMMISSIONER GARCIA:** Clearly, as
4 good-hearted as the people of BellSouth are, I'm
5 certain they are not in this business for their health
6 or the general welfare of its employees, although I'm
7 sure it's something it takes into consideration. But
8 all corporations, at least the ones that are created
9 to make money, are in the business of making money.

10 **WITNESS SCHEYE:** Yes.

11 **COMMISSIONER GARCIA:** So I would assume that
12 the integration would have some type of concept in
13 terms of making money; not leaving the financials even
14 when it's all said and done.

15 **WITNESS SCHEYE:** Absolutely. BST's might be
16 even. Our financials, if we market correctly will be
17 positive. We will stimulate other services. We will
18 incent customers to come with us, and those types of
19 things. So the combination of BST, let's say, being
20 financially whole, or the same, and BSE hopefully
21 making a profit, in that combination we'd hope the
22 shareholder is benefited.

23 **COMMISSIONER GARCIA:** Then address the
24 question for me, and I know that you have in your
25 testimony, but humor me. I guess -- your opponents

1 here -- what if it did work out? In essence what
2 BellSouth figured out would be a way to get around the
3 modified final judgment, the Telecommunications Act,
4 271 proceedings, this Commission, so that it could
5 offer integrated long distance service as well as the
6 other things you mentioned.

7 **WITNESS SCHEYE:** First of all, let's
8 assume -- again, if I can take your scenario and we've
9 got half the customers in Florida, one at our package
10 just as a scenario. I think a couple of things
11 happen. One is nothing changes in terms of BST's
12 obligations under the Act. It still has to resell at
13 a discount. It still has to provide unbundled network
14 elements. It still has to provide interconnection to
15 any and all carriers. So no other carrier is at all
16 jeopardized by my success or failure from that
17 standpoint.

18 Secondly, if there's any sort of secondary
19 benefit to other carriers, clearly BSE would become a
20 very large user, in your scenario, of BST's
21 operational support systems.

22 We will be putting pressure, just like any
23 CLEC, for BST to make those systems as efficient as
24 possible, as seamless as possible; whatever the
25 parameters are.

1 So if there's any benefit to the other
2 carriers, it's us being in business, being successful
3 and using those operational support systems just like
4 they do. And if they perceive that we have leverage
5 over our affiliate, BST, that -- we don't believe we
6 do, but if we did, it would probably result in
7 improved systems, not jeopardized systems. So we
8 think in that case everyone is better off.

9 **COMMISSIONER GARCIA:** Would there even be
10 need to file a 271 proceeding at this Commission if we
11 went forward under this scenario?

12 **WITNESS SCHEYE:** Oh, absolutely. We don't
13 get long distance relief through this process. The
14 long distance relief, and the ability to bundle long
15 distance still comes from the corporation, still must
16 be approved by the -- first by this Commission for
17 BST, and then taken to Washington for approval of long
18 distance. We can not provide long distance services
19 until such time as all of that occurs.

20 **COMMISSIONER GARCIA:** BellSouth BSE could.

21 **WITNESS SCHEYE:** No. BellSouth BSE can not,
22 nor can any other affiliate of BellSouth until it is
23 approved to do so.

24 **COMMISSIONER JACOBS:** I have a question. In
25 the scenario where you have one client that has

1 locations in other states outside of your service
2 area, and you're going to service them on this package
3 offering from BellSouth BSE. The arrangements that
4 you're going to enter into with BST, BellSouth
5 Telecommunications, are going to be in your service
6 area; is that correct?

7 **WITNESS SCHEYE:** That's correct,
8 Commissioner.

9 **COMMISSIONER JACOBS:** The locations of that
10 client that are outside of BellSouth
11 Telecommunications' service area, what are going to be
12 elements -- how are you going to develop the terms of
13 the contract with respect to those locations?

14 **WITNESS SCHEYE:** In addition to having an
15 agreement with BST, we're currently negotiating with
16 GTE, Bell Atlantic, Southwestern Bell, Ameritech for
17 similar interconnection or resale arrangements. So we
18 will have the same kind of arrangement with those
19 incumbent local exchange carriers as we will with BST.
20 That will be the basis for which we would then put all
21 of those services together to provide the package to
22 the customer.

23 **COMMISSIONER JACOBS:** When you say same,
24 you're indicating that -- the same discount
25 relationship?

1 **WITNESS SCHEYE:** It will be the same
2 discount relationship. Each state has a unique
3 discount that has basically been determined through
4 arbitration proceedings. It will vary a few
5 percentages state by state. For example, in Florida,
6 I believe the residence discount is about 20%. In
7 Kentucky it's 16% and it varies. Each state has a
8 unique percentage discount. Of course, their basic
9 rates are also different.

10 **COMMISSIONER DEASON:** Do you plan on
11 providing service by resell, or UNEs or a combination?

12 **WITNESS SCHEYE:** Initially resale and
13 movement to UNEs when it becomes economical.

14 **COMMISSIONER DEASON:** Have you negotiated an
15 Interconnection Agreement with BST?

16 **WITNESS SCHEYE:** We have a BST agreement for
17 Kentucky. We've not finalized the agreement in
18 Florida. And basically we believe either we can
19 negotiate one based on the arbitration proceeding, or
20 we'll operate under the generally available terms and
21 conditions.

22 **COMMISSIONER CLARK:** Mr. Scheye, suppose
23 you're successful in getting maybe a supermarket chain
24 to be their local service provider. You could do that
25 throughout Florida; is that right?

1 **WITNESS SCHEYE:** We could do that --

2 **COMMISSIONER CLARK:** Throughout Florida.

3 **WITNESS SCHEYE:** Today we could do that
4 throughout Florida, correct, Commissioner.

5 **COMMISSIONER CLARK:** Well, not today.

6 **WITNESS SCHEYE:** BSE could not. I'm sorry.
7 BellSouth Corporation, through BST, because it has a
8 certified ALEC, could provide services in Orlando and
9 those areas. None of us can provide service to the
10 small independent territories.

11 **COMMISSIONER CLARK:** All right. So
12 BellSouth -- not BSE -- well, BellSouth and BSE could
13 provide that same service; is that correct?

14 **WITNESS SCHEYE:** Correct. Once we're
15 certified.

16 **COMMISSIONER CLARK:** But neither one of you
17 can provide long distance service?

18 **WITNESS SCHEYE:** Correct. Until we're
19 certified by the FCC, or approved by the FCC.

20 **COMMISSIONER CLARK:** Explain to me again why
21 you think it's advantageous then to have a separate
22 certificate?

23 **WITNESS SCHEYE:** The certificate we're
24 seeking here in Florida, again for statewide
25 certification, allows us to do things beyond what BST

1 is doing within its own territory and even what it's
2 doing as an ALEC in Orlando right now

3 COMMISSIONER CLARK: Like what?

4 WITNESS SCHEYE: Well, again, no one is
5 providing the full integration of services. We do not
6 believe even after long distance, that BST will
7 necessarily even be able to fully integrate it.

8 COMMISSIONER CLARK: A full integration of
9 what kind of services? I'm sorry, I have trouble
10 dealing in the abstract. You have to tell me exactly
11 what you think --

12 WITNESS SCHEYE: Maybe it's simpler to just
13 deal with a couple simple packages. Let's say a
14 simple package of local exchange service, cellular
15 service and eventually your long distance, where you
16 might pay -- these are theoretical, fictitious
17 rates -- for \$60 a month you get a residence line, a
18 cellular service and so much long distance service.
19 Flat fee. And that's what you pay every month. You
20 have a single point of contact, if you want to make
21 any changes or orders. That's what we're talking
22 about, full integration of service. So it's simply a
23 packaging of various --

24 COMMISSIONER CLARK: And the current local
25 exchange, the ILEC, can not package the cellular and

1 the -- why can't it package --

2 WITNESS SCHEYE: It can do certain
3 packaging. It can package cellular.

4 COMMISSIONER GARCIA: Tell me what it can't
5 do, because I'm having a problem.

6 COMMISSIONER CLARK: That's a good point.
7 What can't it do?

8 WITNESS SCHEYE: The distinction that we see
9 in terms of what it can and can't do --

10 COMMISSIONER GARCIA: Because maybe we did
11 something wrong, so maybe we should correct it as
12 opposed to create another corporation.

13 WITNESS SCHEYE: I'm not sure you did
14 anything right or wrong. But the issue at hand is
15 whether BST, the incumbent, can fully integrate long
16 distance service once the approval is obtained. And
17 the distinction is the FCC rules deal with the joint
18 marketing capability that BST has, and it's
19 questionable whether that includes the full
20 integration, as we're talking about, \$60 type package.
21 In terms of cellular.

22 COMMISSIONER GARCIA: Explain that to me. I
23 need to understand. What do you mean? That if some
24 day we approve you in the 271 proceeding, and FCC
25 follows us and approves BellSouth to enter the long

1 distance market, you think that that approval will
2 have restrictions on it? And, therefore, BellSouth ---
3 you, BellSouth, not the new corporation -- the
4 existing BellSouth -- will not be able to integrate
5 those services? Or is it a corporate mind-set that
6 won't allow your salesmen to be able to market?

7 **WITNESS SCHEYE:** No, no, it's not a
8 corporate issue at all. Under the Act and the FCC
9 rules, there's a joint marketing limitation and what
10 the incumbent can do with the long distance. It can
11 jointly market those services. In other words, if you
12 were to call up the business office -- this is, again,
13 in the future, they would be able to deal with you in
14 long distance. That's part of the joint marketing.
15 It's questionable, however, that they would be able to
16 fully incorporate and integrate that into a singular
17 package to you to have a single point of contact for
18 that service to make any changes.

19 For example, today it's not uncommon for you
20 to buy a service at one location, but have to call
21 multiple different people to get it serviced or get
22 multiple bills.

23 **COMMISSIONER GARCIA:** Give me an example of
24 when you do that today with BellSouth, and why you do
25 that.

1 **WITNESS SCHEYE:** Well, for example in
2 BellSouth, as a good example, we ran a trial --

3 **CHAIRMAN JOHNSON:** I'm sorry, Commissioner,
4 you were asking questions.

5 **COMMISSIONER CLARK:** No. You're following
6 the same line.

7 Mr. Scheye, what I find -- what's troubling
8 to me is you say there may be issues of joint
9 marketing. I thought that joint marketing had to do
10 with whether or not you had -- what was the
11 distinction in the law on joint marketing?

12 **WITNESS SCHEYE:** The distinction was that
13 the incumbent -- when the Act set up a separate
14 subsidiary, a 272 subsidiary for long distance
15 services, that's the entity that can provide the long
16 distance.

17 **COMMISSIONER GARCIA:** What was the answer
18 you just said?

19 **WITNESS SCHEYE:** There's a separate
20 subsidiary required for the provision of long
21 distance. That's a 272 -- Section 272 subsidiary.

22 **COMMISSIONER CLARK:** Let me interrupt you.
23 And you have to have the 271 approval to do that.

24 **WITNESS SCHEYE:** Correct.

25 **COMMISSIONER CLARK:** Okay. Go ahead.

1 **WITNESS SCHEYE:** Then you have to go to the
2 FCC and they have to approve you to allow you to do
3 that. And you'll have to do that through what is
4 known as 272 subsidiary. And when you certified
5 conditionally BellSouth Long Distance basically that's
6 the 272 subsidiary in question.

7 In addition, the Act and the FCC allow the
8 incumbent, in our case BST, to jointly market the
9 services of that 272 subsidiary, or to jointly market
10 long distance services.

11 **COMMISSIONER CLARK:** Is that under Track A
12 and Track B?

13 **WITNESS SCHEYE:** Yes. It's irrelevant how
14 you got to Washington. Track A and Track B is your
15 ticket to Washington.

16 **COMMISSIONER CLARK:** What is relevant to the
17 joint marketing? Something is relevant to the joint
18 marketing, I just can't remember.

19 **WITNESS SCHEYE:** What's relevant to it? Now
20 I'm trying to guess -- what's relevant is the
21 abilities or limitation placed on the incumbent in its
22 relationship with the 272 long distance subsidiary.

23 **COMMISSIONER CLARK:** Go ahead, Mr. Scheye.

24 **WITNESS SCHEYE:** I guess -- and one of the
25 things -- we have not established this company solely

1 on the basis of what BST can not do. That's not our
2 primary goal in life. It was set up so we could focus
3 on packages, so we could focus on the multi-state
4 environment and we could do so in a manner that is
5 consistent with all other CLECs.

6 Our motivation was not so much what one
7 entity couldn't do, but rather what we thought a good
8 market condition was to be met and the better way to
9 focus on it. And we felt that was better to be done
10 through a separate company, and that company operating
11 like all other CLECs, did not jeopardize competition.
12 In fact, we thought it promoted competition. And sort
13 of relying on some of the past FCC rulings, where the
14 FCC looked at many of these same issues and many of
15 these same concerns, and said, "Yes. We agree it's in
16 the public interest and we agree that new and
17 innovative services can be derived from this manner of
18 operation. We feel confident that we were well within
19 the letter of the law and the requirements to do it in
20 that manner."

21 COMMISSIONER CLARK: So, to sum, then you
22 are not suggesting that there are things that BSE can
23 do, and the reason you formed them was they were
24 things that BST could not do.

25 WITNESS SCHEYE: With one exception. And

1 that is back to -- it's not -- because the joint
2 marketing requirements have not been fully fleshed out
3 and interpreted. It's very possible that BST may not
4 be able to fully integrate the long distance service
5 into a package in the same manner we could. When I
6 mean fully integrated, it's one-stop shopping: one
7 point of contact and one incorporated price.

8 **COMMISSIONER CLARK:** Why do you have doubts
9 that you'll be able to do that?

10 **WITNESS SCHEYE:** The doubts are just
11 interpreting what joint marketing means. I may market
12 someone's service or you may market someone's service
13 but it's someone else's.

14 **COMMISSIONER CLARK:** What is it that leads
15 you to focus on joint marketing and there being doubt
16 that you can do it? What law, rule or order leads you
17 to raise that concern?

18 **WITNESS SCHEYE:** Basically, the FCC's -- as
19 best we can see -- definitions, and the concern raised
20 by the other parties in those proceedings. When the
21 FCC had dockets on joint marketing, many of the
22 parties -- most of the parties tried to put
23 limitations on what the incumbent local exchange
24 carrier could do under the joint marketing provisions.

25 We're anticipating that when this actually

1 comes to market, there will be a lot of scrutiny and a
2 lot of review of those types of rules to the point of
3 saying, "yes you can and no you can't" do these types
4 of things. It's difficult to predict the outcome of
5 those types of decisions.

6 COMMISSIONER CLARK: Mr. Scheye, I'm still
7 having trouble understanding why there is even a
8 concern in your mind.

9 Are you referring to once an entity is given
10 authority under 271 to provide interLATA long distance
11 service, it's still not clear under some provision
12 that you would be allowed to joint market it.

13 WITNESS SCHEYE: No, you could joint market
14 it. But what is the meaning of joint marketing is
15 where the concern arises.

16 COMMISSIONER CLARK: What is the rule, order
17 or law that has given rise to your concern as to the
18 way joint marketing will be interpreted?

19 WITNESS SCHEYE: I'd have to refer --
20 primarily I think it's FCC Docket 96149. And they --
21 there's a lot of discussion amongst the parties as to
22 what an affiliate can do and what the incumbent can
23 do.

24 COMMISSIONER CLARK: And what is the law or
25 what is the provision in the Telecommunications Act

1 that gives rise to that discussion?

2 WITNESS SCHEYE: I believe it's in either
3 Sections 271 or 272. I'd have to find it and I think
4 probably find out.

5 COMMISSIONER CLARK: Well, I suggest you do
6 by the time you come up on rebuttal.

7 Let me ask you another thing. You talked
8 about integrated and joint marketing things, and you
9 talked about doing cellular, local and long distance,
10 assuming you had authority under 271, and you may
11 offer a package for \$60.

12 As a CLEC, would you be required to offer
13 that to MCI? Say, they could buy it at \$60 and then
14 resell it?

15 WITNESS SCHEYE: The local exchange portion
16 would have to be available for resale, not necessarily
17 the other components. Not the cellular component or
18 long distance component.

19 COMMISSIONER CLARK: So it's only going to
20 be the local service that you will be required to
21 resell?

22 WITNESS SCHEYE: Yes.

23 COMMISSIONER CLARK: Okay.

24 COMMISSIONER DEASON: How do you determine
25 at what price you have to resale?

1 WITNESS SCHEYE: I'm sorry?

2 COMMISSIONER DEASON: How do you determine
3 at what price is a packaged service, and by definition
4 "package" means it's a group of services for one
5 rate -- how do you determine what rate is applicable
6 to the local portion of that package?

7 WITNESS SCHEYE: We will have to break the
8 package apart for several reasons and determine
9 precisely which portion is the local exchange piece.

10 One, I believe we're required under the
11 Florida Commission's price list to have a price for a
12 local exchange service. Two, the taxation portion --
13 the taxes on the local exchange pieces, especially in
14 Florida, would vary from the other components, say the
15 cellular or long distance. If the \$60 -- and I'm
16 going to make this up -- we'd have to determine that
17 each is \$20 each. It probably wouldn't work out that
18 smoothly. And the third reason is for universal
19 service fund. Typically there's a basis of local
20 exchange revenue that has to be attributed for which
21 one pays. So we would have behind \$60 the three
22 components and how they were encompassed for those
23 reasons.

24 COMMISSIONER DEASON: Are there any
25 guidelines which you have to follow which require you

1 to allocate that package price to the local component
2 in any certain way, or is that at your discretion?

3 **WITNESS SCHEYE:** There are no specific
4 guidelines. I think the biggest issue would be
5 taxation, if we -- for example if the taxes were
6 larger on the local exchange piece than they were,
7 say, on the cellular piece. And we said of the \$60,
8 \$1 is local exchange and \$59 for cellular, I suspect
9 the tax people would have a problem with that. So we
10 will allocate based on our input cost basically. That
11 would be the guideline we use. So if we were to pay
12 \$for 18 each of them and mark them up \$2 for our own
13 cost, it would be \$20 each.

14 **COMMISSIONER DEASON:** Is that something this
15 Commission has authority to review?

16 **WITNESS SCHEYE:** Interestingly, I believe
17 the Commission has outstanding a proposal for the
18 price list, whether the complete packages must be
19 submitted with the price list. And I assume if they
20 adopt that particular rule, they would have the right
21 to review the underlying components to see what
22 encompassed the package. We have no problem with
23 giving it to the Commission, if that's a question.
24 Even if they don't, we would want it to be
25 proprietary.

1 **CHAIRMAN JOHNSON:** You talk in your
2 testimony about the FCC proceeding where they at least
3 looked at the issue of discrimination and
4 cross-subsidy addition.

5 **WITNESS SCHEYE:** Yes.

6 **CHAIRMAN JOHNSON:** I'm not very familiar
7 with that particular proceeding. Were these issues
8 the exact same issues? And is this a 272 affiliate as
9 the FCC would have described it?

10 **WITNESS SCHEYE:** Yes.

11 **CHAIRMAN JOHNSON:** I know you say here that
12 the arguments that are being raised were argued at the
13 FCC. Is this the proceeding where they talked about
14 they didn't want to stifle innovation or creativity.
15 Explain more. You talked about it for about ten
16 sentences here. Could you explain a little more about
17 that proceeding and the FCC's determinations on this
18 specific issue?

19 **WITNESS SCHEYE:** Yes.

20 **CHAIRMAN JOHNSON:** I may be confusing it
21 with another one of their proceedings where they
22 talked about innovation and creativity and not wanting
23 to stifle that.

24 **WITNESS SCHEYE:** That's a small piece of
25 this one. In the docket, it's 96149, is the

1 particular FCC docket, they were dealing with, amongst
2 a lot of things, of course, one of them was the
3 relationship between affiliates, Bell operating
4 company affiliates, and what could an affiliate of the
5 incumbent do and not do, and how it would be dealt
6 with.

7 Basically -- and a lot of concerns were
8 raised similar to the concerns raised here. Basically
9 what the FCC concluded was that there were adequate
10 rules for nondiscrimination in place. That if a
11 affiliate of an incumbent wanted to resell or use
12 unbundled network elements of the incumbents to create
13 a local exchange service of its own, it was clearly
14 allowed to do so and it was allowed and consistent
15 with the Act.

16 Parties raised several different concerns,
17 one of which was the use of unbundled network elements
18 and the use of resale.

19 Essentially, most of the parties -- AT&T and
20 MCI in particular -- basically conceded that resale
21 was less problematic than the use of unbundled network
22 elements. The concern raised about unbundled network
23 elements had to do with what happened to the access
24 charges. And the FCC, in its evaluation of that,
25 claimed that to be unpersuasive and felt there were

1 more than adequate rules in place to take care of any
2 of those concerns.

3 Further, the FCC -- because, again, it was
4 argued to the FCC that having an affiliate provide
5 local exchange services was not in the public
6 interest. The FCC found, indeed, it was in the public
7 interest. And one of their reasonings was that
8 affiliate would develop new and innovative services to
9 bring to the market that the incumbent may not.

10 All of that is encompassed in one fairly
11 large section of that particular docket. There were
12 certainly other issues that the FCC dealt with,
13 accounting safeguards and those kinds of things, also
14 incorporated. But I'm referencing the specific part
15 about the affiliates and the integration of
16 affiliates.

17 **CHAIRMAN JOHNSON:** Were there objections to
18 you setting up similarly situated CLECs in Alabama or
19 in South Carolina? Or did it pass without objections
20 being filed?

21 **WITNESS SCHEYE:** No. We had plenty of
22 objections in all --

23 **CHAIRMAN JOHNSON:** So did you hold similar
24 proceedings in both those --

25 **WITNESS SCHEYE:** Yes. Absolutely. We've

1 also had them in two other states. But the three
2 decisions that were made, South Carolina, Alabama and
3 in Georgia, similar parties, if not the same parties,
4 did intervene. And I was cross examined in those
5 cases under essentially the same issues.

6 CHAIRMAN JOHNSON: Okay. Thank you.

7 COMMISSIONER CLARK: Mr. Scheye, just one
8 thing. Is Texas the only one that has said no?

9 WITNESS SCHEYE: Michigan also said no to
10 GTE, but not to Ameritech. And their reasoning for
11 GTE was they -- first they approved Ameritech, and
12 then limited GTE in Michigan. And they said the
13 reasoning was it was conditional; that GTE had not
14 abided by the arbitration requirements that the
15 Michigan Commission had handed down to GTE. For
16 example, GTE was supposed to have signed an agreement
17 with, I believe, it was AT&T -- but whichever carrier
18 it was, they had not done so. And the Michigan
19 Commission felt that until such time as GTE had opened
20 its territory up to competition, it was not correct to
21 allow GTE to go outside and beyond to compete more
22 effectively. So they conditioned their approval on
23 GTE meeting the requirements of arbitration.

24 COMMISSIONER CLARK: What was the basis on
25 which Texas denied it?

1 **WITNESS SCHEYE:** The Texas decision is based
2 on an unique Texas law that does not allow one entity,
3 in this case GTE, to hold two different certificates
4 in the same geographic area. There's a particular law
5 in Texas that we have found to exist in no other
6 state.

7 **COMMISSIONER CLARK:** Okay. Thanks.

8 **CHAIRMAN JOHNSON:** Mr. Ellis.

9 **COMMISSIONER JACOBS:** Can I ask one more
10 question?

11 Let's go to the circumstance where BSE will
12 be providing a service through unbundled elements and
13 you'll have a package again; the cellular, the
14 entertainment. Are those going to be actually
15 produced by BSE or will you be likely contracting with
16 other providers for those services?

17 **WITNESS SCHEYE:** We would contract with
18 other providers, either BellSouth entities or
19 non-BellSouth entities, depending on the area.

20 **COMMISSIONER JACOBS:** In that event, will
21 you -- let's say you have -- let's look specifically
22 at a collocation arrangement, okay? If there were a
23 joint -- let's say a sister BellSouth entity who will
24 provide one of your services that you're going to
25 package, would it be -- could it be possible that they

1 would join in with one of these agreements to share
2 use of one of your unbundled elements?

3 **WITNESS SCHEYE:** They would not be allowed
4 to do so. Only a CLEC could enter into a collocation
5 or similar agreement with an incumbent. Our cellular
6 company, or our long distance company, or paging
7 company would not be certified to do so, so they could
8 not engage and share in our agreement.

9 **COMMISSIONER JACOBS:** That's all.

10 **CHAIRMAN JOHNSON:** Mr. Ellis.

11 **MR. ELLIS:** I just have a couple more,
12 Mr. Scheye.

13 **Q** **(By Mr. Ellis)** Is it true that BSE could
14 provide any or all of the package of entertainment
15 services, cellular services and Internet services
16 without purchasing local exchange service from
17 BellSouth Telecommunications at a discount?

18 **A** I think the answer is yes, we could provide
19 it, but we don't see much of a market without the
20 local piece in it.

21 **Q** You could do that both within the nine-state
22 BellSouth Telecommunications' territory and outside?

23 **A** Could do that -- well, couldn't do it
24 outside because those entities of BellSouth don't
25 provide services anyplace beyond the BellSouth region.

1 But I guess, in theory, we could contract with another
2 entertainment provider.

3 Q As it stands now you intend to contract with
4 BellSouth Telecommunications for those services then?

5 A For the local exchange piece, sir. That's
6 the only piece.

7 Q How about for the Internet, cellular --
8 excuse me, the Internet, the cellular, and the
9 entertainment services?

10 A For the Internet we would, if available, use
11 BellSouth.net, which is another affiliate. For the
12 entertainment, if it's available, we would use
13 BellSouth Entertainment, again if it happened to have
14 entertainment services or cable TV in those areas. If
15 it didn't, we'd have to contract with a different
16 vender.

17 Q And, of course, if you go outside the
18 nine-state BellSouth Telecommunications area, you have
19 to contract with somebody else for the provision of
20 the services, at least until you're able to provide
21 them yourself?

22 A That's correct, sir.

23 COMMISSIONER GARCIA: So the local services
24 is your question, right?

25 MR. ELLIS: I'm just trying to separate out

1 the local services from everything else.

2 **WITNESS SCHEYE:** In the case -- just to get
3 the clarification -- if we were outside the BST
4 territory, we'd contract with some other incumbent for
5 the local piece and presumably some other entities for
6 the other pieces as well as.

7 **Q** **(By Mr. Ellis)** And you can do that without
8 being able to purchase local exchange service from
9 BellSouth Telecommunications at a discount?

10 **A** I can, again, do that, but I have restricted
11 my marketing capability dramatically.

12 **Q** And after, or if and when BellSouth is
13 permitted to provide long distance service -- excuse
14 me, a subsidiary of BellSouth Corporation is
15 certificated to provide long distance services, and
16 BSE is able to provide those services, again you could
17 provide any or all of that package of long distance,
18 Internet, cellular and entertainment and local
19 exchange services without being able to purchase the
20 local exchange services at a discount from BellSouth
21 Telecommunications?

22 **A** Again, technically correct. But what you're
23 saying is I could operate outside the BST territory, I
24 think, in that scenario. And we don't believe there's
25 significant market viability if we cannot include the

1 BST territory as part of the overall capabilities that
2 we have.

3 Q The only two things that BellSouth BSE can
4 do that BellSouth Telecommunications can not, before
5 and after it's able to provide long distance services,
6 is a) to provide outside the nine-state territory, and
7 b) to sell local exchange service at a discount
8 without being required to make that discount available
9 to competitors?

10 A Well, let me say I think that's a yes and
11 no. If I sold the local exchange service -- and I
12 believe Commissioner Clark's question was similar to
13 that -- if I bought the local service at \$18 but my
14 price list price was \$15, I would have to make it
15 available to everyone at \$15 and continuously lose
16 money. So the part of that is no, I don't plan to
17 provide it at a discount in that fashion. I do
18 believe, but I can't recall, the first part of your
19 question, I think, was in the affirmative, though, was
20 correct.

21 Q First part being BellSouth
22 Telecommunications can't go outside its nine-state
23 territory?

24 A Correct.

25 Q The other is if BellSouth Telecommunications

1 provides local exchange service, which, of course, it
2 does, it has to provide that for resale at a discount,
3 and BSE would not?

4 A Correct. We do not have to provide it at a
5 discount.

6 Q Those are the only two differences between
7 BellSouth Telecommunications and BellSouth BSE in
8 terms of your marketing plan?

9 A Again, not to bring it back, but the full
10 integration of the long distance eventually is also an
11 aspect.

12 MR. ELLIS: Thank you.

13 COMMISSIONER DEASON: Mr. Scheye, you have
14 to resell -- BSE would have to resell at whatever
15 BSE's going rate is that you offer to customers; is
16 that correct?

17 WITNESS SCHEYE: We would have to resell at
18 the going discount --

19 COMMISSIONER DEASON: No. If you provide --
20 for example, let's just say if you're providing a
21 local service as BSE and the rate is \$17 a month.

22 WITNESS SCHEYE: Yes.

23 COMMISSIONER DEASON: And I don't care if
24 you're getting it from -- at whatever rate you're
25 getting it from BST. That's the rate at which you

1 have to offer it for resale to someone else. Is that
2 correct?

3 WITNESS SCHEYE: Yes, that's correct,
4 Commissioner.

5 CHAIRMAN JOHNSON: Staff.

6 CROSS EXAMINATION

7 BY MS. BEDELL:

8 Q Good afternoon, Mr. Scheye. Just to follow
9 up on the last question by Commissioner Deason, where
10 is the -- what authority are you relying on related to
11 our reselling services?

12 A The Telecommunications Act.

13 Q Do you know what part?

14 A I'll find it before I come back up.

15 Q Okay.

16 A I believe it's 251-A but I'll check it.

17 Q Thank you. Is it your understanding that
18 BSE would need to come to this Commission to get an
19 IXC certificate if it wants to provide long distance
20 service in Florida --

21 A Yes.

22 Q -- once BST has the 271 authority?

23 A Yes.

24 Q Okay. And if this Commission were to grant
25 the certificate that's at issue here, and if

1 complaints are filed concerning a y kind of
2 anticompetitive behavior that's been discussed here by
3 the intervenors, would PSC Staff have access to your
4 records to investigate those kinds of complaints?

5 A Yes, certainly.

6 Q And in your opinion would granting the
7 certificate allow BellSouth --

8 COMMISSIONER DEASON: Excuse me for just a
9 second.

10 I'm usually not one to point up when a
11 question seems to be legal and question whether you
12 have the authority to answer it or not, but it seems
13 to me that, perhaps, is a legal question. Is your
14 answer binding on the company? That if that situation
15 arises, that this Commission has the legal authority
16 to go and look at the underlying records to determine
17 if there's any anticompetitive activity?

18 WITNESS SCHEYE: Again, in the context --
19 and, again, as I've said many times before this
20 Commission, I'm not a lawyer. But it is my
21 understanding in the context of a formal complaint or
22 a complaint by a customer, the Commission has the
23 right to request discovery of documents, issue
24 interrogatories, et cetera, and we're bound to answer
25 them as best we can. So if that required in the

1 complaint process -- again, if it was a complaint of
2 anticompetitive behavior and you wanted to see --
3 request for our underlying records, as far as I know,
4 at least in my experience, we're compelled to turn
5 them over or indicate a good reason why we can't or
6 shouldn't.

7 **COMMISSIONER DEASON:** It may be that it
8 would be subject to some type of proprietary or
9 confidentiality, but it would be available to the
10 Commission.

11 **WITNESS SCHEYE:** Yes. A lot of times that's
12 the case, Commissioner, if it's marketing data. And I
13 can speak for the Company, I have no problem turning
14 over information to the Commission if that's what the
15 Commission needs to be satisfied of our operation.

16 **Q** **(By Ms. Bedell)** Would granting this
17 certificate allow BellSouth Telecommunications to
18 circumvent the restrictions placed on RIOCs in the
19 Telecommunications Act?

20 **A** Absolutely not. There's no impact on BST's
21 obligations under the Act and the way they will
22 perform them.

23 **MS. BEDELL:** Staff doesn't have any further
24 questions, but we would like to have Mr. Scheye's
25 deposition identified as an exhibit, and moved into

1 the record.

2 We have his exhibit and his deposition
3 transcript, and three other attachments to it which
4 are our interrogatories and our production of
5 documents request and one late-filed exhibit, if we
6 could do that as a composite exhibit.

7 CHAIRMAN JOHNSON: We'll mark that as
8 Composite Exhibit 4, short title RCS-9. Is that it.

9 MS. BEDELL: That's it for Staff.

10 (Exhibit 4 marked for identification.)

11 CHAIRMAN JOHNSON: Commissioners, any other
12 questions? Redirect?

13 MR. EARLY: We have no redirect, but as I
14 indicated at the initiation of this proceeding, we do
15 have the orders that are referred to in Mr. Scheye's
16 testimony, and I'd like to have those introduced into
17 the record of this proceeding.

18 CHAIRMAN JOHNSON: Mr. Early, did you have
19 them listed or just you mean throughout the text?

20 MR. EARLY: Pardon me?

21 CHAIRMAN JOHNSON: Are they listed in
22 chronological --

23 MR. EARLY: They are not listed in his
24 testimony but he does refer to the states in which
25 ALEC or CLEC, depending on how you want to call them,

1 certificates have been granted with unrestricted
2 statewide authority to affiliates of ILEC . And we do
3 have copies of each of those orders, with the
4 exception of one order in Pennsylvania, which we have
5 not been able to put our hands on.

6 CHAIRMAN JOHNSON: You've made the copies of
7 those orders available?

8 MR. EARLY: I have copies for all parties,
9 all Commissioners and Staff.

10 CHAIRMAN JOHNSON: Is there any objection to
11 that?

12 MR. EARLY: What I propose to do is just go
13 ahead and identify them individually and give you all
14 copies. And it would take two or three minutes to do
15 it. That way we have the identification on the
16 record.

17 CHAIRMAN JOHNSON: Okay. Very good.

18 MR. EARLY: The first order is the order in
19 the state of Alabama.

20 CHAIRMAN JOHNSON: Could you help him?
21 Perhaps someone else could pass them out and Mr. Early
22 could --

23 MR. EARLY: The first order is the Report
24 and Order in the state of Alabama entitled
25 "Application for a Certificate of Public Convenience

1 and Necessity to Provide Local Telecommunications
2 Service," Docket 26192. And I'm going to do these
3 alphabetically.

4 CHAIRMAN JOHNSON: Okay.

5 MR. EARLY: The second order is the state of
6 Connecticut. State of Connecticut, it's Application
7 of SNET America, Inc. for a Certificate of Public
8 Convenience and Necessity. This order -- I'm sorry
9 Docket No. 97-03-17, reflecting a date of June 25,
10 1997.

11 We have two Florida orders that I believe --
12 Staff, you all have already entered for Florida -- we
13 have the Florida GTE certification and the Florida
14 Sprint certification.

15 MS. BEDELL: Yes.

16 MR. EARLY: And those are already in.

17 The order in Georgia is to BSE, it's
18 entitled "Interim Certificate of Authority to Provide
19 Competitive Local Exchange Telecommunications
20 Services," Docket No. 8043, Document No. 21493, issued
21 March 9, 1998.

22 The next order is the order of the state of
23 Kansas in the matter of application of Sprint
24 Communications Company LP for a certificate of Public
25 Convenience to Provide Switched Local Exchange and

1 Exchange Access Service in Kansas, Docket No.
2 96-SCCC-657-COC, with a date stamp of August 7, 1996.

3 The next document is entitled "Report and
4 Order" before the Public Service Commission of the
5 state of Missouri, entitled "In the Matter of
6 Application of Sprint Communications Company LP for a
7 Certificate of Service Authority to Provide Basic
8 Local Telecommunications Service and Local Exchange
9 Telecommunications Service," Case No. number TA-96724,
10 with an issue date of February 28th, 1997, and an
11 effective date of March 11, 1997.

12 The next order is one referred to by
13 Mr. Scheye in his testimony. It's the state of
14 Michigan, before the Michigan Public Service
15 Commission, in the matter of application of Ameritech
16 Communications, Inc. for a license to provide basic
17 local exchange service in Ameritech Michigan and GTE
18 North, Incorporated exchanges in Michigan, case number
19 U-11053.

20 The next document is the state of Nebraska
21 before the Nebraska Public Service Commission, in the
22 matter of the Application of Sprint Communications
23 Company LP, for an Amendment to its Certificate of
24 Public Convenience and Necessity to Provide Local
25 Exchange Telecommunications Service within the state

1 of Nebraska, application number C-13-6, entered March
2 10, 1997.

3 Before the Public Utilities Commission in
4 Nevada, In re: Application of Sprint Communications
5 Company LP, for Authority to Operate as a Competitive
6 Provider of Interexchange Telecommunications Services
7 within the state of Nevada. Docket No. 969014.

8 CHAIRMAN JOHNSON: Go ahead and finish the
9 last one.

10 MR. EARLY: Well, I have another box.

11 CHAIRMAN JOHNSON: Another box? I thought
12 this was it.

13 MR. EARLY: I think the other box has about
14 eight more orders.

15 CHAIRMAN JOHNSON: You can just stack them
16 up. And I know you need to go through the boxes so
17 you can list them out for us to make sure we have them
18 all. You can do that from there, just list them and
19 he can pass them out later.

20 COMMISSIONER GARCIA: The Chairman is scared
21 he may get dizzy and fall down. We wouldn't want
22 anyone to hurt themselves. (Laughter)

23 MR. EARLY: The next order is before the
24 state of New Jersey, Board of Public Utilities, in the
25 Matter of Petition of Sprint Communications Company LP

1 for Approval to Provide Local Exchange
2 Telecommunications Service, Docket No. TE 96060479.

3 CHAIRMAN JOHNSON: Mr. Early, if you can
4 tell us the titles of each of them he can pass them
5 out later, and that way we'll have --

6 MR. EARLY: I don't have a list. I'm just
7 reading them off --

8 CHAIRMAN JOHNSON: I was afraid of that.

9 COMMISSIONER CLARK: Can I make a
10 suggestion? If we go through the questioning -- is
11 Mr. Scheye up here on rebuttal now?

12 MR. EARLY: He'll be coming back on
13 rebuttal.

14 COMMISSIONER CLARK: Why don't you, when you
15 come back up on rebuttal, give us a list and we'll
16 mark it as an exhibit and we'll put everything in the
17 record.

18 MR. EARLY: I actually don't have a list. I
19 have the orders.

20 COMMISSIONER CLARK: Somebody can make the
21 list while we have the other witnesses.

22 MR. EARLY: Okay.

23 MR. LIGHTSEY: Thank you.

24 CHAIRMAN JOHNSON: So, Mr. Early, we're
25 through New Jersey, but if go ahead and go Alabama

1 through New Jersey --

2 MR. EARLY: Start with -- since you have up
3 through New Jersey to start with North Carolina, which
4 would be the next one.

5 CHAIRMAN JOHNSON: That's fine.

6 Are there any other matters for your witness
7 at this time?

8 MR. EARLY: That's all we have at this time.
9 Thank you.

10 CHAIRMAN JOHNSON: You can be excused.

11 WITNESS SCHEYE: Thank you.

12 MR. MCGLOTHLIN: Chairman Johnson, I move
13 Exhibit 3.

14 CHAIRMAN JOHNSON: Show Exhibit 3 -- that
15 was the Kentucky order?

16 MR. MCGLOTHLIN: Right. Application.

17 CHAIRMAN JOHNSON: Admitted without
18 objection. Mr. Early, you had Exhibit 2 which was a
19 composite exhibit.

20 MR. EARLY: Exhibit 2, that was the
21 composite exhibit contained as an attachment to
22 Mr. Scheye's testimony.

23 CHAIRMAN JOHNSON: We'll show that admitted
24 without an objection. And Staff, Exhibit 4.

25 MS. BEDELL: Yes.

1 **CHAIRMAN JOHNSON:** Show that, too, admitted
2 without objection.

3 (Exhibits 2, 3 and 4 received in evidence.)

4 **MR. MCGLOTHLIN:** Chairman Johnson,
5 Commissioners, FCCA, AT&T and MCI are jointly
6 sponsoring the testimony of Joseph Gillan, who we call
7 now.

8 - - - - -

9 **JOSEPH GILLAN**

10 was called as a witness on behalf of FCCA, MCI & AT&T
11 and, having been duly sworn, testified as follows:

12 **DIRECT EXAMINATION**

13 **BY MR. MCGLOTHLIN:**

14 **Q** Would you please state your name and
15 address?

16 **A** Joseph Gillan, P. O. Box 541038, Orlando,
17 Florida 32854.

18 **Q** Mr. Gillan, did you prepare and submit in
19 prefiled form your direct testimony in this
20 proceeding?

21 **A** Yes.

22 **Q** Do you have that document before you?

23 **A** Yes.

24 **Q** Do you have any changes or additions or
25 corrections to make?

1 A No.

2 Q Do you adopt the questions and answers
3 contained in the document as your direct testimony in
4 this proceeding?

5 A Yes.

6 MR. McGLOTHLIN: I request Mr. Gillan's
7 direct testimony be inserted in the record at this
8 point.

9 CHAIRMAN JOHNSON: It will be inserted as
10 though read.

11

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Direct Testimony of
Joseph Gillan
on behalf of the
Florida Competitive Carriers Association,
AT&T Communications of the Southern States, Inc.,
and
MCI Telecommunications Corporation

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

2

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

6

7 Q. Please briefly outline your educational background and related experience.

8

9 A. I am a graduate of the University of Wyoming where I received B.A. and M.A.
10 degrees in economics. From 1980 to 1985, I was on the staff of the Illinois
11 Commerce Commission where I had responsibility for the policy analysis of
12 issues created by the emergence of competition in regulated markets, in
13 particular the telecommunications industry. While at the Commission, I served
14 on the staff subcommittee for the NARUC Communications Committee and
15 was appointed to the Research Advisory Council overseeing NARUC's research
16 arm, the National Regulatory Research Institute.

17

18 In 1985, I left the Commission to join U.S. Switch, a venture firm organized to
19 develop interexchange access networks in partnership with independent local

1 telephone companies. At the end of 1986, I resigned my position of Vice
2 President-Marketing/Strategic Planning to begin a consulting practice.

3
4 Over the past decade, I have provided testimony before more than 25 state
5 commissions, four state legislatures, the Commerce Committee of the United
6 States Senate, and the Federal/State Joint Board on Separations Reform. I
7 currently serve on the Advisory Council to New Mexico State University's
8 Center for Regulation.

9
10 **Q. On whose behalf are you testifying?**

11
12 **A.** I am testifying on behalf of AT&T Communications of the Southern States Inc.
13 (AT&T), MCI Telecommunications Corporation (MCI), and the Florida
14 Competitive Carriers Association (FCCA). The FCCA is an association with a
15 broad membership, committed to the development of competition across all
16 services and all areas of Florida.

17
18 **Q. Please explain the fundamental issue in this proceeding.**

19
20 **A.** There is really a single issue of importance to this proceeding: just how many
21 BellSouths does it take to provide local service in its own territory? In the
22 testimony which follows, I explain that because *consumers* will discern only

1 one BellSouth -- and *investors* will evaluate a single BellSouth -- no valid
2 purpose would be accomplished by a regulatory system that pretends that there
3 are two. The Commission should reject BellSouth's request for a second local
4 certificate in its own territory.

5
6 **Q. Please identify the various BellSouths referenced in this proceeding.**

7
8 **A. To make more clear the discussions which follow, I refer to (and distinguish**
9 **between) the three principal BellSouths with the following nomenclature:**

10
11 (1) BellSouth, refers to the holding company which is the single
12 entity of economic relevance to investors and the only point at
13 which BellSouth's management is judged,

14
15 (2) BellSouth Telecommunications (BellSouth-T), is the existing
16 local exchange carrier providing service in Florida, and

17
18 (3) BellSouth-BSE, is the "new" local exchange carrier seeking
19 authority in this proceeding to compete as a competitive ALEC.

20
21 (In addition to being the incumbent local exchange carrier, BellSouth-T
22 applied for and received an ALEC certification.)

1 Q. Please summarize the purpose of your testimony.

2

3 A. The purpose of my testimony is to explain why the Commission should deny
4 BellSouth a certificate to "compete against itself" through the legal artifice of
5 BellSouth-BSE. By requesting a certificate as an Alternate Local Exchange
6 Carrier (ALEC), BellSouth is seeking a form of back-door deregulation that
7 would be every bit as effective as if the company had directly requested that
8 the Commission repeal the Telecommunications Act of 1996, Chapter 364, and
9 rewrite its rules to eliminate the distinction between BellSouth and legitimate
10 entrant-competitors.

11

12 I want to make clear at the outset, however, that the carriers sponsoring my
13 testimony have no objection to BellSouth's entry and participation as an ALEC
14 outside its own territory. As BellSouth-BSE seeks to win and serve the
15 customers of GTE and Sprint, BellSouth-BSE will exist as a distinct competitor
16 to these incumbent LECs, with a unique market presence and an economic
17 relationship no different than any other entrant.

18

19 Within BellSouth-T's territory, however, BellSouth-BSE is a sham entrant, a
20 second BellSouth indistinct from the incumbent LEC. In every meaningful
21 way, BellSouth-BSE is BellSouth-T. The sole purpose for BellSouth-BSE is to
22 engage in market behavior that BellSouth-T is not, for good reason, allowed --

1 with the collateral effect of diluting (if not avoiding) BellSouth's obligations
2 under the federal Act intended to promote local competition.

3

4 **Q. What is an Alternate Local Exchange Carrier?**

5

6 A The Florida regulatory structure is founded on a fundamental distinction
7 between new entrant local companies (authorized to enter the market no sooner
8 than January 1, 1996) and incumbent local telephone companies, including
9 BellSouth-T. The statute makes clear that it is the policy of the State of
10 Florida to respect the very real differences between entrant and incumbent local
11 carriers (see, for instance, FS 364.01(4)(c) which directs the Commission to
12 promote competition by subjecting new entrants to a lesser level of regulatory
13 oversight than incumbent local carriers).

14

15 For the state statute to have meaning, the ALEC designation is intended for a
16 fundamentally different *economic* unit than the incumbent local exchange
17 carrier. Similarly, the federal Act is premised on a clear distinction between an
18 incumbent LEC and its entrant-competitors. The central point of my testimony
19 is that no such economic distinction can or will exist between BellSouth-BSE
20 and BellSouth-T, even if a superficial legal distinction applies.

21

22 **Q. Is it reasonable to consider BellSouth-BSE as an "alternative" to**

1 **BellSouth-T?**

2

3 A. No, not within BellSouth-T's territory. BellSouth-BSE has a market and
4 economic relationship to BellSouth-T which eliminates any meaningful
5 distinction between these entities.

6

7 First, BellSouth-BSE will not occupy a unique position in the market. Within
8 BellSouth's region, BellSouth-BSE will trade on the same name recognition as
9 BellSouth. The legal distinction in its name will have no practical market
10 significance in the eyes of consumers.

11

12 Second, the Commission should place no faith in the superficial claim that
13 BellSouth-BSE will interact with BellSouth-T on an arms-length basis.
14 BellSouth-BSE and BellSouth-T only exist -- in the eyes of investors -- as a
15 single economic entity (BellSouth). There are no financial or market incentives
16 for these companies to do anything other than maximize shareholder value -- a
17 single objective inconsistent with an "arms-length" relationship.

18

19 **The Fallacy of the Separate Identity**

20 Q. **Is it reasonable to expect consumers will distinguish between BellSouth-T**
21 **and BellSouth-BSE?**

22

1 A. No. In exchanges served by BellSouth-T, BellSouth-BSE's application is not
2 a request to *enter* a new market as an ALEC. Rather, this application
3 represents BellSouth's *reentry* to its *own* markets through a *second* distribution
4 channel (i.e., BellSouth-BSE) with lower regulatory obligations.

5
6 First, it is clear that BellSouth has chosen to name BellSouth-BSE with the
7 intention of capitalizing on the BellSouth name. Mr. Scheye testified in South
8 Carolina that BellSouth-BSE will trade on the BellSouth name, logo and
9 reputation (Docket 97-361-C):

10

11 ... [w]hile there has not been an explicit discussion, it's been,
12 generally, that we would market under the BellSouth name ...
13 [Tr. 24]

14

15 Q. Is BellSouth-BSE going to use the little bell logo?

16

17 A. I would certainly hope so. Yes. [Tr. 25]

18

19 Q. You indicate ... that one of the reasons why you wanted to do this, ...
20 was to get in business and not be restricted by your BellSouth territory
21 ... why not start there?

22

1 A. Why not start in the 41 other states?

2

3 Q. Instead of starting where you have a presence already?

4

5 A. Two reasons. One, is clearly the BellSouth name is not as well
6 known there. Secondly, in the business market the idea would
7 be, a company that might have a founding already here in one of
8 our 9 states but has branches in other states. We would try to
9 attract all that business. Conversely, if I started in California
10 and Utah and I don't have a presence there, I don't have a
11 reputation there, I don't have a name there and probably have
12 little basis for going into business. [Tr. 76].

13

14 Even if consumers could discern a clear difference between BellSouth-BSE and
15 BellSouth-T, there is no reason why BellSouth would want consumers to do so.
16 The very fact that BellSouth has chosen to name its new affiliate BellSouth
17 (albeit with a BSE on the end) reveals its intent to blur any distinction between
18 these companies.

19

20 Q. Why is consumer-perception important?

21

22 A. The problem stems from BellSouth's position as an exchange monopolist. This

1 position of incumbency provides BellSouth certain market advantages (like
2 already serving *all* of the local customers in its territory). Both the state and
3 federal statutes have imposed specific obligations on BellSouth -- from price-
4 cap regulation, tariffs to avoid discrimination, and the requirement to open the
5 network to others -- to curb BellSouth's ability to exploit the advantages of this
6 incumbency.

7
8 By creating a legal entity that is imperceptibly different in the market -- but
9 which is subject to none of the obligations of an incumbent carrier -- BellSouth
10 is able to retain all the market advantages of incumbency while gaining all the
11 flexibility of non-dominance. This strategy provides BellSouth its desired
12 deregulatory freedom, without the inconvenience of actually losing any market-
13 control.

14
15 **Q. What would be the effect of BellSouth being able to compete in the same**
16 **market through two legal entities, but one market presence?**

17
18 **A.** It is impossible to predict with certainty *every* problem that would be created
19 by authorizing BellSouth to offer the same set of services through two entities -
20 - each subject to different rules and obligations -- in the same market.
21 However, there are three adverse consequences from their proposal that are
22 immediately apparent.

1 First, BellSouth will have gained an ability to improperly benefit its
2 unregulated affiliate through costs incurred by its regulated twin. For instance,
3 BellSouth has recently announced a \$20 million advertising campaign intended
4 to promote "BellSouth's" technological skills. Like all product non-specific
5 advertising, these adds will promote BellSouth-BSE and BellSouth-T without
6 differentiation. (In fact, it is difficult to conceive of any advertisement that
7 includes the BellSouth name and logo that would not benefit BellSouth-BSE.)
8

9 Second, BellSouth-BSE would provide BellSouth the ability to discriminate in
10 favor of select customers by offering targeted products through BellSouth-BSE
11 that are not generally available to other BellSouth customers. BellSouth-BSE
12 would (according to BellSouth) be treated like any other ALEC, with the
13 ability to contract with customers outside of BellSouth's tariffs and otherwise
14 applicable rules.
15

16 Third, BellSouth could use BellSouth-BSE to avoid its obligations under the
17 federal Act, in particular its obligation to permit the unrestricted resale of its
18 services at wholesale rates.
19

20 **Q. How would granting BellSouth-BSE local service authority in BellSouth-**
21 **T's territory enable BellSouth-T to evade its wholesale obligation?**
22

1 A. The federal Act establishes a number of tools to accelerate the entry of
2 competitors to the exchange market, including the resale of local exchange
3 service. The viability of the resale entry option is dependent upon the margin
4 between the retail rates available to consumers and the wholesale prices paid by
5 entrants.

6

7 The premise of the wholesale pricing option is that the relevant "retail" price is
8 the tariffed rate of the incumbent local exchange carrier, in this case BellSouth-
9 T. Approving BellSouth-BSE would violate this principle by providing
10 BellSouth *two* legal entities -- yet a *single* market presence -- to offer its local
11 services. BellSouth would be able to repric existing services and introduce
12 new ones through BellSouth-BSE without any obligation to offer a wholesale
13 equivalent subject to the appropriate discount. In effect, the "retail" price
14 *relevant* to the wholesale entry option would be different than BellSouth-T's
15 list price to which the wholesale-discount obligation applies.

16

17 For instance, BellSouth-T's local rate today (Rate Group 12) is \$10.65, to
18 which the Commission-approved discount of 19% applies. As a result, the
19 wholesale margin is \$2.02. BellSouth-BSE, however, could offer the identical
20 service, to the same customers, for \$8.65 -- which, from the customer's
21 perspective, is equivalent to "BellSouth" reducing its rates by \$2.00. Because
22 the lower rate is offered by BellSouth-BSE, however, the wholesale discount

1 would not apply, the margin available to the competing reseller to cover its
2 own costs would be eliminated, and legitimate resale-based competitors would
3 be driven from the market.

4
5 **Q. Do you have any other concerns with respect to BellSouth-BSE's request?**

6
7 **A.** Yes. Although I have focused solely on the most obvious abuse, BellSouth's
8 request for its BellSouth-BSE affiliate can be viewed more fundamentally as
9 effort to obtain the regulatory flexibility of non-dominant regulatory status
10 without first losing (and, as a consequence, perhaps *never* losing) its dominant
11 market position. The point of my testimony relates to how this structure will
12 impact rivals and the potential for local competition. But the Commission
13 should also consider, as a separate matter, whether it *ever* makes sense to
14 permit BellSouth to approach the same set of customers, with effectively the
15 same set of services, marketed under a single corporate identity, but using twin-
16 providers subject to different regulatory rules.

17
18 **The Fallacy of Arm's-Length Independence**

19
20 **Q. Does BellSouth-BSE have the same economic relationship to BellSouth-T as**
21 **other entrants?**

1 A. No. Only BellSouth-BSE enjoys an identity of ownership with BellSouth-T.
2 As such, there is shareholder-indifference with BellSouth as to whether a
3 service is sold by BellSouth-T or BellSouth-BSE: the effect on BellSouth's
4 investments, expenses, revenues and, ultimately, profits is identical. When you
5 own the pants, it does not matter in which pocket you keep your money.

6
7 Of course, this same calculus does not apply to any other competitor. If the
8 Commission were to grant this certificate, any price paid by BellSouth-BSE to
9 BellSouth-T would be no more than a transfer from one BellSouth pocket to
10 another. By contrast, the prices that entrants pay BellSouth-T are a real
11 economic cost they incur. Similarly, any shifts of customers from BellSouth-T
12 to BellSouth-BSE would be all in the family. On the other hand, if a bona fide
13 new entrant loses a customer to BellSouth-T, a real market loss occurs. Only
14 BellSouth-BSE can view BellSouth-T as a partner and not a competitor.

15

16 **Q. Is there any evidence that BellSouth-BSE will operate independently of**
17 **BellSouth-T (and, for that matter, BellSouth)?**

18

19 A. No. Testimony in other states confirms the obvious -- BellSouth-BSE is simply
20 not an independent economic unit. For instance, Mr. Scheye acknowledges that
21 his primary mission (as well as that of other BellSouth management) is to
22 maximize shareholder value (Docket 26192, Alabama PSC, Tr. 40):

1 ... in our company, at least, what we try to do is to maximize the
2 value for the stockholder.

3
4 As noted, however, there is a single stockholder for BellSouth-BSE -- the same
5 stockholder of BellSouth-T. There can be no true "arm's length" relationship
6 between these firms since each has the objective of maximizing the same
7 return.

8
9 Second, the absence of independence is also evident in the formulation of
10 BellSouth-BSE's board (South Carolina Docket 97-361-C, Tr. 45):

11
12 AT&T Counsel: Now I take it, all of these wholly owned
13 subsidiaries, none have a separate Board of
14 Directors?

15
16 Mr. Scheye: They do have a Board. Typically 1 or 2 people.
17 Typically they are Bell south people. They don't
18 [have] an outside Board if that's what you're
19 talking about.

20
21 There is no independent voice because there is no independent purpose --
22 BellSouth-BSE is nothing more (within BellSouth's serving territory) than

1 BellSouth-T's deregulated twin.

2

3 **Q. Are there other examples which demonstrate that BellSouth-BSE is not an**
4 **independent economic unit?**

5

6 A. Yes. BellSouth-BSE has indicated that it intends to operate primarily by
7 reselling BellSouth-T's retail services (South Carolina Docket 97-361-C, Tr.
8 59). Service-resale is only financially viable, however, if the entrant can
9 provide marketing and customer support more efficiently than the incumbent --
10 and not just modestly so, but by at least an amount necessary to offset any
11 price discount needed to attract the customer.

12

13 Apply this equation to the operations of BellSouth-BSE. Is there any reason to
14 expect that BellSouth-BSE can provide marketing and customer service more
15 efficiently than BellSouth-T? Will BellSouth-BSE have greater skills than
16 BellSouth-T? If so, how -- BellSouth-BSE is staffed primarily by former
17 BellSouth-T employees.

18

19 *The only reason that service-resale is attractive to BellSouth-BSE is because*
20 *the fundamental economics of service resale do not apply to BellSouth-BSE.*

21 Each dollar BellSouth-BSE pays for the services it resells it pays to a sister
22 company; its marketing costs are reduced because it benefits from each

1 advertisement run by its sister company; and the price discounts it must offer to
2 attract customers from BellSouth are reduced because it will be perceived as
3 the incumbent. BellSouth-BSE is an accounting fiction immune from the
4 standard financial constraints of its chosen entry strategy.

5
6 **Q. The Texas Public Service Commission recently addressed a similar issue
7 with respect to GTE. How did the Texas Commission respond?**

8
9 **A. The Texas PUC rejected a similar twin-provider request with the legal-rationale
10 that its state statute did not contemplate issuing two types of certificates in the
11 same territory to the same company or an affiliate. The Commission's press
12 release expounded on its reasoning as follows:**

13
14 "If we allow regulated companies to use an affiliate in their own
15 territory to avoid their responsibilities and to enter the
16 competitive market, we make a mockery of the whole regulatory
17 and legal scheme," said Commissioner Judy Walsh. Both Walsh
18 and Chairman Pat Wood, III, said that letting GTE's affiliate
19 compete in GTE's service area would be counter productive to
20 the competitive local telephone market the PUC is working to
21 establish in Texas.

22

1 Q. Should the Commission approve BellSouth-BSE's certificate and just wait
2 to address any problems that arise?

3
4 A. No. The problems created by BellSouth-BSE's certification within BellSouth-
5 T's franchised area are structural and systemic to its proposal. The concerns
6 identified are not idle speculation, but are the easily predictable consequences
7 of creating the incentives that lie at the heart of its request. For instance,
8 BellSouth-BSE's resale of BellSouth-T's services provides a clear example of
9 BellSouth-BSE achieving a market-posture that is possible only because
10 BellSouth-BSE's affiliate relationship.

11
12 The fact of the matter is that BellSouth-BSE *is* BellSouth in the eyes of both
13 consumers and investors -- and, as such, is not an independent economic unit in
14 any meaningful way. The Commission should not allow BellSouth to use the
15 legal pretense of a separate BellSouth-BSE to accomplish through the back-
16 door a level of regulation that its rules, the Florida statute, and federal Act
17 would not grant directly.

18
19 At the outset of my testimony, I asked (somewhat rhetorically) just how many
20 BellSouths does it take to provide local service in its franchised areas? The
21 answer is one. The Commission should deny BellSouth-BSE's request to
22 operate as an "alternate" local carrier within BellSouth-T's operating region.

1 Q. If the Commission grants BellSouth-BSE an ALEC certificate to compete
2 in the territory served by BellSouth-T, what conditions or modifications
3 should the Commission impose?
4

5 A. If the Commission grants BellSouth-BSE a certificate to compete as an ALEC
6 in BellSouth-T's serving territory, it should make as a condition of BellSouth-
7 BSE certification BellSouth-BSE's acceptance of all the obligations applicable
8 to an incumbent LEC in the Federal Act, as well as the requirements of
9 Chapter 364 and the Commission's rules applicable to non-ALEC local carriers.
10

11 If BellSouth-BSE's purpose in applying for the certificate is to be able to
12 package certain products together and to "follow" certain customers who move
13 or add locations, as described in Mr. Scheye's testimony, then such conditions
14 would not present any impediment to BellSouth-BSE's stated goals.
15

16 Q. Does this conclude your direct testimony?
17

18 A. Yes.

1 Q (By Mr. McGlothlin) Mr. Gilan, have you
2 prepared a summary?

3 A Yes.

4 Q Would you proceed, sir?

5 A Yes. Well, the one-sentence summary is that
6 we believe that there are already enough BellSouths in
7 the BellSouth serving territory for the current
8 marketing conditions. There's BellSouth
9 Telecommunications, the incumbent LEC, and there's
10 already BellSouth Telecommunications with an ALEC
11 certificate.

12 In our opinion the primary purpose for
13 BellSouth-E is for BellSouth to use the device of
14 certification to effectively become deregulated. Not
15 deregulated by losing their market share, not
16 deregulated by losing their market position, but
17 deregulated by creating a deregulated entity and then
18 having that entity offer the services that people will
19 demand in the future so that over time customers will
20 move to the new unregulated entity.

21 Now, what is wrong with this? Basically,
22 that this new unregulated entity will have -- will not
23 in any way lessen BellSouth's market dominance.
24 Customers will still understand that we're getting
25 phone service from BellSouth. The fact that it's now

1 labeled BellSouth BSE, or whatever name they actually
2 end up choosing to use in the marketplace, they will
3 still be perceived as BellSouth by customers.

4 **COMMISSIONER DEASON:** Mr. Gillan, let me ask
5 you a question. Even the competitors -- and I'll use
6 the term "traditional competitors" meaning AT&T, MCI,
7 others other than BSE -- if they pursue a resale
8 strategy or utilization of UNEs, that's not going to
9 diminish BellSouth BST's incumbent status either, is
10 it not? They are still going to have market share,
11 it's just going to be wholesale as opposed to retail.

12 **WITNESS GILLAN:** Yes and no. It is true
13 that the fundamental network position that BellSouth
14 has is going to take many, many years to diminish.
15 But there is a fundamental difference between using
16 network elements to provide service and using service
17 resale. And one of the problems I see with the
18 BellSouth BSE application is that they will be a
19 successful reseller because they, and they alone, are
20 paying all their dollars to their sister company. So
21 that at the level that it matters, when BellSouth
22 Corporation has to go to its investors and say "We
23 either made money or we didn't" it's not going to
24 matter whether the dollars came in through BellSouth
25 BSE or BellSouth-T. What matters is that combined

1 profit statement, and with service resale, that
2 combined profit statement is very profitable for
3 BellSouth. Yet any other service reseller has to make
4 all of its money on the service that it's reselling,
5 so they will not be able to compete with BellSouth on
6 that basis.

7 COMMISSIONER DEASON: If we set the prices
8 correct, why is it that BST -- it seems to me BST
9 would be indifferent as to whether they resold to BSE
10 or resold to AT&T. Why would BST care who they resold
11 to? They are getting the same revenue stream, are
12 they not?

13 WITNESS GILLAN: I don't believe BST would
14 care necessarily. But what I can say is that if
15 you -- and actually I have a numeric example that
16 shows that BellSouth, as a corporation, can use
17 service resale to compete in the marketplace in the
18 way that nobody else can. So it's true BST may have
19 no reason -- they would be indifferent as to whether
20 they sold it through BellSouth Enterprises or AT&T on
21 a financial basis. They are certainly not indifferent
22 whatsoever to keeping that customer in the BellSouth
23 family and having that customer go to a competitor who
24 might ultimately take it to a different network.

25 Most fundamentally, they can go into this

1 market as reseller, operate very profitably, capture
2 this market, and, in fact, their own projections filed
3 with their application would show they, themselves,
4 expect this company would be wildly successful.
5 Yet -- and the reason is that the economics of service
6 resale are just fundamentally different for this
7 corporation than any other entrant. So they are going
8 to create --

9 COMMISSIONER GARCIA: Give me some basics on
10 why it's fundamentally different.

11 WITNESS GILLAN: I think at this point I
12 have a numeric example based on actual BellSouth
13 numbers in Florida that I could take you through in
14 answer to that question. It would be a lot easier and
15 would also make the rest of my summary unnecessary.
16 Does that work?

17 COMMISSIONER GARCIA: Maybe the parties may
18 have an objection to it, but if not, it would be fine.

19 COMMISSIONER DEASON: Mr. Gillan, the fact
20 that this makes the rest of your summary unnecessary,
21 is that an incentive for us to look at this?

22 WITNESS GILLAN: I would think so, yes.

23 (Laughter)

24 COMMISSIONER GARCIA: That's what decided it
25 for me.

1 WITNESS GILLAN: It's certainly why I
2 offered that observation.

3 MR. MCGLOTHLIN: Could we have a number for
4 identification, Chairman Johnson?

5 CHAIRMAN JOHNSON: It will be identified as
6 Exhibit 5, and short title "Comparing Economics of
7 Service Resale."

8 (Exhibit 5 marked for identification.)

9 WITNESS GILLAN: This document is actually
10 split into two sections. One looks at it for serving
11 a typical business customer, and the bottom one is
12 serving as a typical residential customer. For
13 brevity, I'll just take you through the business
14 customer example where the results are more pronounced
15 but they apply in either scenario.

16 COMMISSIONER GARCIA: Which one is more
17 pronounced?

18 WITNESS GILLAN: The business customer
19 scenario. By way of background, the revenues and the
20 cost numbers used on this are taken from, or derived
21 from Mr. Varner's exhibit in -- what might
22 colloquially be known as the UNE combination
23 proceeding of a couple of weeks ago. And I'll take
24 you through what serving a customer looks like to
25 BellSouth on the top first, and then through the

1 reseller.

2 When BellSouth, as a corporation approaches
3 this customer through BSE, BSE -- the typical business
4 customer represents revenues of about \$57.66. In
5 order to serve that customer, BSE would incur the cost
6 of resold goods at 49.34. So when it, quote,
7 "constructs its package" this is what it says it is
8 doing for local exchange service. But BSE doesn't
9 exist as an economic unit. They are owned entirely by
10 BellSouth Corporation. And the \$49 it takes out of
11 one pocket simply goes into the pocket of BellSouth
12 Telecommunications.

13 Importantly, in a resale scenario, BSE --
14 the reseller continues to share the customer with the
15 underlying carrier in a way where the underlying
16 carrier gets the resold revenue and it gets the access
17 revenue, even though it would incur an economic
18 cost -- and this is the cost based elements derived by
19 the Commission -- of \$28. So at the end, when
20 BellSouth looks at this customer, it sees a revenue
21 stream from the customer, it sees a net revenue stream
22 of one affiliate paying another that has no impact on
23 its bottom line. It gets the access revenues, and
24 incurs a network cost, and it has a gross margin from
25 that typical business customer -- and this isn't a

1 large business customer, it would be a customer that
2 doesn't use a PBX -- of \$42 a month. A reseller, on
3 the other hand, may have access to the same revenue
4 stream, but when it writes that check to BellSouth, it
5 isn't paying an affiliate. It incurs it as a very
6 real cost. And the margin it has for its shareholders
7 is only \$8.

8 What this emphasizes is that it would take a
9 very modest reduction in price by BellSouth
10 enterprises to completely eliminate the margin
11 available to an entrant, effectively blocking them out
12 of this market, even though at the same time BellSouth
13 itself, through its two enterprises, would still be
14 very profitable serving that customer.

15 **CHAIRMAN JOHNSON:** Mr. Gillan, could you go
16 over that again? The last point you made, you said
17 BellSouth could do what and cut out --

18 **WITNESS GILLAN:** BellSouth could go to the
19 same customer and offer a CSA for, say, \$50. So it
20 reduced the customer's bill from \$57 down to \$50.

21 **MR. McGLATHLIN:** Mr. Gillan, you said
22 BellSouth. Did you mean BSE in that --

23 **WITNESS GILLAN:** BSE. I apologize.

24 **CHAIRMAN JOHNSON:** BSE.

25 **WITNESS GILLAN:** BellSouth BSE. It could

1 offer that customer a contract for \$50. So
2 BellSouth's revenues dropped by \$7 and its profit
3 margin from this customer would drop to \$35. It would
4 still be a very profitable customer for BellSouth to
5 retain, and they would now have them under a contract.
6 However, the reseller could never compete against that
7 \$50 price because they would have to pay \$49 to
8 BellSouth to obtain the things they need to offer the
9 service. Their margin would effectively go away. It
10 would not be profitable for them to serve the
11 customer. So that would be an example of that
12 customer being taken out and put in sort of a
13 protected mode simply because BellSouth Enterprises,
14 or BellSouth BSE, doesn't have to -- is not subject to
15 resale or any of the other requirements.

16 **CHAIRMAN JOHNSON:** If BSE did what you just
17 suggested, is there anything the Commission could do,
18 or other providers? Would you know that this was
19 occurring if they tried to resell at \$50 instead after
20 \$57.66 and we saw that the gross margin for that one
21 company was 32 cents, or \$1.32, is there a complaint
22 process? Is there a way to get at that kind of
23 activity?

24 **WITNESS GILLAN:** I don't believe so in a
25 practical sense.

1 First of all, the contract arrangement that
2 BellSouth BSE would enter into wouldn't be required to
3 be filed with this Commission. So there wouldn't be
4 any automatic documentation here. So it would take a
5 while for all of these different instances to be
6 understood in the marketplace, then somebody would
7 have to collect them. Given the fact there's all
8 these different competitors, I don't believe -- it
9 would take a lot of this to first occur before any
10 kind of systematic collection effort would happen.
11 And even then, when we brought it to you, what would
12 we be complaining about? Realistically BellSouth
13 would come back and say, "Hey, I didn't go below my
14 wholesale price. And I'm making my money on the other
15 things in the package."

16 So, I don't want to -- give them all of
17 their arguments in advance, in a practical sense I
18 believe that at that point it -- you would find out
19 about it way late in the market process, and there
20 would be so little you could do about it that you may
21 not even see the complaint. Yet to me the bottom line
22 here is that there's nothing that BellSouth can't do
23 already with its current legal authority, including
24 create a division that has the some focus that
25 Mr. Scheye says BellSouth wants -- the sole reason

1 that they are creating a corporation is that
2 corporation will have a different paper -- a set of
3 legal requirements to comply with BellSouth-T. And
4 that's the principle source of our concern.

5 COMMISSIONER DEASON: Mr. Gillan, under that
6 example, if BellSouth -- BSE were to offer their
7 service at \$50 as opposed to 57.66, that reduces their
8 margin, does it not?

9 WITNESS GILLAN: Yes.

10 COMMISSIONER DEASON: Okay. Why is it then
11 from the corporate -- why is that advantageous for
12 BellSouth to reduce its own gross margin?

13 WITNESS GILLAN: If it's facing no
14 competition at all, it's not advantageous. If it's
15 facing any little bit of competition, then this is the
16 way for them to lock in the customer base and do it on
17 a mass market scale in a way that others won't have
18 the opportunity to use -- to compete; to capture that
19 customer.

20 COMMISSIONER DEASON: Let me interrupt you
21 for just a second. If we were to put AT&T in the
22 place of BSE, it's still the same gross margin they
23 are going to get, is it not?

24 WITNESS GILLAN: No.

25 COMMISSIONER DEASON: Why is it the gross

1 margin differs if we were to assume this same set of
2 numbers and just, at the top, where it says "BSE" just
3 put "AT&T."

4 WITNESS GILLAN: Because AT&T's margin --
5 when it pays the \$49 to BST, that money is forever
6 gone. BST has the money then. This works because
7 BellSouth owns both BST and BSE, and, therefore, that
8 \$49 transfer payment nets out. If I put AT&T's name
9 up at the top, it may have \$57 coming in the door but
10 it would have to actually pay \$49 to BellSouth that it
11 would never see on its books again. It would be a
12 very real expense. So as that price drops, that
13 margin narrows. And this is what really goes -- for
14 that part of this point goes --

15 COMMISSIONER GARCIA: I mean the
16 competitor has no expense that BellSouth has when it
17 pays that out. BellSouth sees it back on its books.
18 BellSouth has an expense that if AT&T were doing that
19 they would have that expense or something like it,
20 that's why they are using BellSouth's network, right?

21 WITNESS GILLAN: No. Because of the unique
22 circumstances of service resale.

23 There's that revenue stream, then there's
24 also the access revenues, and then the true expenses
25 that BellSouth incurs is the 28.14. The \$49.34 there

1 is not a true cost to BellSouth-T. The true cost is
2 \$28.14, which is the network cost associated with
3 serving the customer.

4 COMMISSIONER DEASON: The network cost is
5 still 28.14 regardless of whether they are reselling
6 to BSE or reselling to AT&T?

7 WITNESS GILLAN: Correct. The network costs
8 that they incur. Then they would get the additional
9 access revenues and the cost of the resold services.

10 COMMISSIONER DEASON: And BST gets access
11 revenue regardless of whether they resell to BSE or
12 AT&T?

13 WITNESS GILLAN: That is correct.

14 COMMISSIONER DEASON: What is the point? I
15 don't understand your point.

16 WITNESS GILLAN: That they don't have to
17 treat BellSouth Enterprises quote, "more favorably"
18 than AT&T, because the deal inherently works for
19 BellSouth BSE and doesn't work for other entrants.
20 Because when you service resale, you're still in
21 business with that local telephone company. In the
22 case -- because the local telephone company continues
23 to offer half the services, the access revenues, et
24 cetera.

25 So in the case of BellSouth Enterprises, the

1 fact that it's still in business with BellSouth-T,
2 they don't care. Because at the end of the day it's
3 the combined profitability that matters to this
4 corporation. For any other entrant, they are not able
5 to use this in the same way that BellSouth Enterprises
6 would, because they have to report their results to a
7 separate independent set of stockholders who are going
8 to ask "Well, what did you do for me? How did you
9 compete?" And the answer is "Using this, I can't."

10 This shows up in BellSouth's own
11 projections. Their internal projections show that
12 BSE, in its first full year of operation, will become
13 roughly 1.5 times the size of the entire CLEC industry
14 nationwide. It's not just a case of it will be the
15 largest CLEC, it will be much larger than the rest of
16 them added together after however many years they have
17 been out in the marketplace trying to do this.

18 COMMISSIONER JACOBS: Isn't the real -- let
19 me ask it this way: The advantage that ultimately is
20 derived from this comes in the final marketing, would
21 you agree? Because from this margin, AT&T or anyone
22 else, if they are going to compete with the package
23 that BSE is going to offer, they've got to go out and
24 acquire cellular service, they've get to go out and
25 contract for the entertainment services, and they are

1 going to pay for those services out of whatever is
2 left over from these revenues. And then BSE is going
3 to go out and do the same thing, but they are looking
4 at it from the perspective of the BellSouth total
5 column. So when they go out to acquire those same
6 services, they are looking at a wholly different
7 margin within which to operate. Do you follow me?

8 WITNESS GILLAN: I think so. Let me give
9 you an answer, then you can tell me if I followed you
10 or not.

11 Different market participants will try to
12 put together the same package. And let's assume for
13 the moment that the package that we're really talking
14 about here is local and long distance and Internet,
15 sort of the core.

16 Well, when you go to add long distance to
17 your package, the long distance market is competitive.
18 There are multiple networks. So the margins that
19 anyone can get from long distance are roughly the
20 same, okay, because it's a competitive marketplace.
21 And whether it's BellSouth going into that market to
22 add long distance, or AT&T, or even a smaller carrier
23 like LCI, that market effectively is going to give
24 everyone roughly the same margin. Similarly when we
25 all go to add Internet to our product line, that

1 market is competitive. So the margins that people
2 will get from Internet are going to be roughly the
3 same because that market is competitive.

4 There's only one market here, one part of
5 the package that's not competitive, that's local. And
6 what this tries to convey to you is how BellSouth BSE
7 will be able to use that local monopoly and gain a
8 margin that won't be available to other competitors.

9 The only reason -- there's no reason at all
10 for BellSouth BSE to exist as a legal entity other
11 than to be subject to a different set of rules.
12 Because everything that BellSouth wants to put
13 together in a package it can do as either BellSouth-T,
14 or even BellSouth-T through its ALEC certificate if it
15 wants to. The only thing here is using a different
16 legal mechanism to become the package provider in the
17 future.

18 And I think that witness after witness in
19 this proceeding, in the UNE combination proceeding and
20 the first 271 proceeding and the next one, and maybe
21 the one after that, they are all going to tell you
22 that that's where the future is. And so the question
23 we're posing to you fundamentally is: Is this how you
24 want to get BellSouth into a deregulated mode through
25 a company that offers the package but isn't subject to

1 any of the rules? And in a serving arrangement that
2 can make sense only for them because of the unique
3 relationship back to BellSouth-T. There's almost too
4 many BellSouths to finish a complete sentence.

5 COMMISSIONER DEASON: In your example the
6 gross margin for BSE is \$8.32, is it not?

7 WITNESS GILLAN: To BSE?

8 COMMISSIONER DEASON: To BSE.

9 WITNESS GILLAN: Yes.

10 COMMISSIONER DEASON: The same as for the
11 reseller entrant.

12 WITNESS GILLAN: That is true.

13 CHAIRMAN DEASON: The margins are the same
14 and the revenues are going to be the same to BellSouth
15 BST regardless of whether they resell to BSE or resell
16 to AT&T; is that correct?

17 WITNESS GILLAN: Initially, yes.

18 COMMISSIONER DEASON: You're trying to
19 characterize that these numbers create an unfair
20 advantage for BellSouth. Why does it create an unfair
21 advantage for BellSouth?

22 WITNESS GILLAN: Well, two reasons.

23 The first reason is BellSouth can offer this
24 customer a lower price and eliminate the reseller
25 margin and BellSouth will still have a very profitable

1 customer, yet other resellers -- anyone else using
2 this entry technique would not be able to do it.

3 COMMISSIONER DEASON: You say it's
4 profitable but that's because of the revenue stream
5 from access and the cost of the resold services. And
6 that revenue stream is going to be the same regardless
7 of whether BST resells to BSE or to the reseller
8 entrant.

9 WITNESS GILLAN: Yes. Maybe -- let me try
10 it this way. I'm not disagreeing with you that on
11 paper BellSouth is indifferent between BellSouth-E
12 acting as the reseller and AT&T. What I'm saying is
13 that strategically BellSouth very much wants that
14 customer to remain part of the BellSouth family. They
15 can do that through this device, offering that
16 customer a contract service arrangement, for instance,
17 eliminating that margin. True, they have taken less
18 money, but now they have that customer locked into a
19 contract arrangement and nobody else can offer that
20 customer, using resale, a comparable price.

21 COMMISSIONER DEASON: Doesn't AT&T do the
22 same thing? It's going to and wants to compete. And
23 if it wants to, it can reduce its gross margin 8.32
24 down to something else, if they can then package a
25 service to where then they retain that customer as the

1 long distance -- get the long distance revenue from
2 that customer, or Internet access or whatever else
3 package of services AT&T is going to provide to their
4 customer. Isn't that correct?

5 WITNESS GILLAN: Yes. Except those other
6 services only provide a competitive margin, whereas
7 BellSouth is going to have the opportunity to lock in
8 the margin from these monopoly prices, and, in my mind
9 just as importantly --

10 COMMISSIONER DEASON: What you're saying
11 then is the Commission erred when it set the price of
12 resold service. And that's not the issue in this
13 proceeding.

14 WITNESS GILLAN: I don't believe that that's
15 what I said.

16 COMMISSIONER DEASON: You're saying the
17 margins are too high on their monopoly service, which
18 is, in this case, what they resell.

19 WITNESS GILLAN: Their monopoly services
20 being the local exchange service and the access
21 service.

22 And the other point was that the Act -- and,
23 in fact, 271 contemplates that BellSouth must make
24 available for resale at a wholesale discount these
25 contract service arrangements. Yet through this very

1 simple artifice, they'll be able to take this
2 customer, who may be under a contract arrangement
3 today, that an entrant would have a right to buy and
4 resell at a wholesale discount, move them on to,
5 effectively, the same product offered by BellSouth.
6 The customer is not going to see any difference, yet
7 suddenly --

8 **COMMISSIONER GARCIA:** He's going to get a
9 better price, isn't he?

10 **WITNESS GILLAN:** Either get a better price
11 or a longer term contract or whatever to get the
12 customer convinced to say, "Oh, yeah. You're
13 BellSouth. I'm getting service from you today. Okay.
14 I'll get the same service from you tomorrow. You're
15 still BellSouth." I mean, there's no question here
16 that BellSouth understands that they want their
17 customers to -- understand that BellSouth BSE is part
18 of BellSouth, and yet now you can't resell that
19 contract arrangement.

20 **COMMISSIONER GARCIA:** Tell me where
21 Commissioner Deason is wrong. It almost alleges then
22 that the prices we set are just too high.

23 **WITNESS GILLAN:** Well, yes, in a sense they
24 are, in that I believe the Act was intended to put
25 other people in this marketplace predominantly over

1 the existing network -- because it's the only one out
2 there -- with the ability to start bring ng these
3 prices down.

4 COMMISSIONER GARCIA: I don't think the Act
5 was meant to take away business from certain people.
6 I think it was meant to create competition. That the
7 competition would have that affect is yet to be seen
8 by everyone. But I don't think it was meant to take
9 away customers, from one person or another, was it?

10 WITNESS GILLAN: We might be just discussing
11 semantics. It's seems to me competition inherently
12 means that customers are going to move among
13 providers.

14 COMMISSIONER GARCIA: All right.

15 CHAIRMAN JOHNSON: Mr. Gillan, do you have
16 any more?

17 WITNESS GILLAN: No. I've finished my
18 summary with that.

19 CHAIRMAN JOHNSON: The witness is available
20 for cross.

21 MR. MCGLOTHLIN: Yes, ma'am.

22 CROSS EXAMINATION

23 BY MR. LIGHTSEY:

24 Q Mr. Gillan, you are testifying today on
25 behalf of AT&T as well as other carriers; is that not

1 correct?

2 A Yes.

3 Q And following this lengthy discussion, it is
4 your opinion that it is the resale of BellSouth
5 Telecommunications Service by BellSouth BSE that
6 possess this potential anticompetitive damage to the
7 marketplace in the state of Florida?

8 A That's one of them, yes.

9 Q So you would disagree with the comments of
10 AT&T that they made before the FCC in the joint
11 marketing docket, in which they said, and I quote,
12 "The joint marketing provisions of Seccion 272(G)
13 likewise make clear that the provision of exchange
14 services by the affiliate, other than through resale,
15 would be inconsistent with the statute."

16 A Yes.

17 Q Now, Mr. Gillan, you testified also --

18 COMMISSIONER DEASON: Can you repeat that
19 statement again that he just disagreed with?

20 WITNESS GILLAN: I didn't disagree with it.
21 I agreed with it.

22 COMMISSIONER DEASON: Oh, you agreed with
23 it.

24 WITNESS GILLAN: Well, I disagree with my
25 client.

1 **COMMISSIONER DEASON:** Okay. You disagreed
2 with your client's position.

3 **WITNESS GILLAN:** Correct.

4 **COMMISSIONER DEASON:** And he quoted your
5 client's position, I thought. What did you quote?

6 **MR. LIGHTSEY:** I quoted the comments of AT&T
7 Corporation before the FCC in the joint marketing
8 docket that we have been discussing extensively today,
9 filed August 15th, 1996.

10 **COMMISSIONER DEASON:** You quoted AT&T's
11 position.

12 **MR. LIGHTSEY:** Yes, sir.

13 **COMMISSIONER DEASON:** Can you quote that
14 again, please? A little slower.

15 **MR. LIGHTSEY:** "The joint marketing
16 provisions of Section 272(G) likewise make clear that
17 the provision of exchange services by the affiliate
18 other than through resale," in parenthesis, "would be
19 inconsistent with the statute."

20 **COMMISSIONER DEASON:** And you disagree with
21 that statement?

22 **WITNESS GILLAN:** That's correct.

23 **COMMISSIONER DEASON:** Can you tell me why
24 you disagree with it?

25 **WITNESS GILLAN:** Because I believe that the

1 principle way you would want -- if BellSouth enters
2 the market through an affiliate, that in order to put
3 them on the same basis as everybody else, they should
4 all be buying from BellSouth network at cost based
5 rates. That would have the least threat of creating
6 competitive problems. If AT&T buys cost based rates
7 and the affiliate buys at cost based rates, then the
8 true economic cost that BellSouth incurs is the same,
9 and each of these -- both AT&T -- I'm sorry -- AT&T
10 would then also incur the true economic cost of those
11 affiliates. That seems to me to be the preferred
12 method.

13 AT&T, admittedly, my understanding in the
14 FCC order which summarized their comments -- and
15 sometimes those summaries are accurate and sometimes
16 they are not -- indicated that AT&T did not share that
17 opinion. I think they are wrong. I think that's the
18 best way for competition to be structured to the
19 structured, to the extent that that's an accurate
20 summary of their statements.

21 COMMISSIONER DEASON: But the reality of it
22 is, is for someone to enter the market quickly, resale
23 is the best way to do that.

24 WITNESS GILLAN: Absolutely not. I don't
25 think resale is any faster than the use of network

1 elements could have been. I think the only thing that
2 makes resale appear to be quicker, is that the
3 incumbent LEC is far more interested in allowing
4 carriers to do that than being able to provide service
5 by buying the network elements and offering service
6 off of them.

7 **COMMISSIONER DEASON:** Well, then in your
8 opinion would the Act be better for the market and
9 customers if there was no resale provisions at all?

10 What is the advantage of having a resale
11 provision then?

12 **WITNESS GILLAN:** I've always thought that
13 resale was useful to two kinds of entrants. One, an
14 entrant that predominantly is in some other business
15 but wants to be able to offer local exchange
16 service -- but really isn't interested in doing
17 anything other than mimicking the local telephone
18 company's product offering.

19 **COMMISSIONER GARCIA:** That would be most of
20 your client.

21 **WITNESS GILLAN:** Absolutely not. I don't
22 believe that that's true at all. I think that most of
23 my clients -- in fact, every client that has retained
24 me for the past four years, the purpose of that
25 consulting arrangement has been to find a way for them

1 to get into the local exchange business on a
2 sustainable basis.

3 Now, that doesn't necessarily mean they're
4 going to build facilities, because facilities are both
5 expensive and time consuming to get out there.

6 But, no, I believe every one of the clients
7 that I've worked for in this arena over the past
8 several years has had a sincere desire to get into the
9 local exchange market.

10 COMMISSIONER GARCIA: You just said to me
11 that resale is made of customers -- one offered as an
12 ancillary business. And then you said but -- and your
13 clients are serious they are getting into local
14 business. And then you followed it by saying but
15 none -- they don't want to build their own networks.
16 So what else do they have? They have resale.

17 WITNESS GILLAN: Well, no. I believe that
18 there's a fundamental difference between leasing the
19 network to provide service and reselling somebody's
20 service.

21 Let me try and give you an example in the
22 long distance business.

23 There are on few companies out there, not
24 very many, which resell somebody's service;
25 effectively just offer it under their own label, but

1 the product and everything else is designed by a
2 different carrier.

3 Generally what occurs in the long distance
4 business is that you buy network capacity. The
5 ability to move a minute from here to anywhere in the
6 country. I mean, that's how BellSouth is going to
7 enter the long distance business. They are not going
8 to build a long distance network. They are going to
9 operate as an facilities reseller. They will buy
10 capacity and they will make their on products, whether
11 they call it MTS, WATS, Dime-A-Minute or 5-Cent
12 Sundays, whatever they call it, that's their decision.
13 They are going to be buying the facilities.

14 I believe that that's effectively what has
15 to happen in the local market as well. The ability to
16 come in, use the local network in that same manner to
17 provide whatever kind of services you want.

18 I sort of lost track now of the original
19 question. I hope I have been responsive to at least
20 the last question, but I'm not sure I was to the
21 original one.

22 **COMMISSIONER GARCIA:** I interrupted you.

23 **COMMISSIONER DEASON:** I think you were
24 explaining to me why resale is a viable option, that
25 it's in the public interest for some competitors but

1 not all.

2 **WITNESS GILLAN:** The thing that is called
3 service resale in the Act, the notion that you
4 actually offer their local telephone services at a
5 wholesale discount, is going to make sense for a
6 couple of entrants. You're beginning to see Internet
7 providers going that path because they are
8 fundamentally, right now, in a different business.
9 Some day these will merge. But I think typically
10 that's perceived as a different operation, but they
11 offer it as part of a package.

12 You also see companies who have -- I'll use
13 BellSouth BSE as an example. When they resell
14 Ameritech service, in Springfield, Illinois, they are
15 not really trying to enter the Springfield, Illinois
16 local exchange market. What they've got is a customer
17 in Atlanta that they are trying to keep, or win, or
18 retain or lock up under a contract, and they are just
19 throwing that in as a way of doing it. Those are the
20 vehicles that I see people using service resale for.

21 Also going back to your original comment, at
22 the time the Act was first passed, I believe that
23 people thought it could occur more quickly than in
24 reality it could occur, or did occur.

25 **COMMISSIONER DEASON:** Then you're saying

1 basically for your clients, they are not reseller
2 entrants. They are entrants using unbundled network
3 elements. And then in that situation they would get
4 the access revenue. And then their rates that they
5 pay to BellSouth would be based upon cost which you
6 think is the superior methodology. So what is AT&T's
7 problem or your other clients' problem with this?

8 WITNESS GILLAN: Well, I'll take -- yes,
9 they would like to be in a position like BellSouth is
10 in the top of either of these examples, residence and
11 business; have the ability to buy network elements and
12 use them in a commercially feasible way. There
13 wouldn't be a problem. But there is no place that you
14 can buy network elements in a commercially feasible
15 way today.

16 And no matter how often you try to get them,
17 you go through a series of regulatory proceedings to
18 get to that result. I mean, that question is an open
19 question here in Florida today. Can you buy --

20 COMMISSIONER DEASON: You don't like the way
21 UNEs are being offered. And I know that's a very
22 serious subject. But should BSE be penalized and not
23 get a certificate because UNEs are not being offered
24 the way you and AT&T would like for them to be
25 offered?

1 WITNESS GILLAN: First of all, BSE doesn't
2 exist as anything other than BellSouth. This is a
3 creature of BellSouth that is nothing but BellSouth.
4 So perhaps it's a visitation of the sins of the parent
5 on the subsidiary. But reality is BSE is BellSouth.
6 Mr. Scheye's testimony in Kentucky on Friday, he
7 proudly said "We are BellSouth."

8 Now, I'm not suggesting that you punish
9 them. But I'm pointing out to you that BellSouth is
10 setting up an arrangement where they are going to be
11 able to compete in a unregulated way, using a vehicle
12 that has advantages to them and them alone, and there
13 isn't any other way for people to get into this market
14 and compete. And there are consequences to that. And
15 I'm encouraging you not to take that step and give
16 them that flexibility.

17 If they were here before you instead saying
18 that they were going to enter the market, they were
19 going to use UNE combinations. Because they were
20 going to use UNE combinations, they were going to get
21 rid of their positions on not making them available to
22 other competitors, and they were going to work
23 cooperatively with the industry to make sure that the
24 operational systems for that entry vehicle are up and
25 running and working, then I would likely have a very

1 different position here. But that's not the proposal
2 before you at all.

3 **COMMISSIONER DEASON:** I think Mr. Scheye did
4 say that he thought the end result of this would be
5 that there would be pressure on BellSouth to make OSS
6 more accessible --

7 **WITNESS GILLAN:** OSS for resale. He will --
8 resale has a different meaning or financial profile to
9 them than to anyone else. And I do believe -- I will
10 take him at his word; that he will ultimately get the
11 OSS systems up and running so that BellSouth BSE can
12 process all of the orders it needs to process to move
13 these customers out from regulation into this
14 regulated entity. I'm not going to disagree with him
15 on that. But I'm going to disagree with whether or
16 not there's anything in the public interest about
17 giving him that vehicle.

18 **CHAIRMAN JOHNSON:** Mr. Gillan, let me focus
19 in on another issue that you raised, or make sure I
20 understand a point that I think you made.

21 Your concern with BSE, I'm looking at the
22 diagram that you provided, is that BSE would have an
23 incentive for that resold revenues, the 57.66, to
24 reduce that to maybe 49.35, and that no other reseller
25 would have that same incentive.

1 **WITNESS GILLAN:** They wouldn't have that
2 same ability, is what I was trying to say. As they
3 reduce that price, this is still going to be a very
4 attractive, very profitable customer for BellSouth.
5 But as they reduce it for others, the profitability is
6 going to go away.

7 **CHAIRMAN JOHNSON:** And it's not necessarily
8 a BellSouth focus, because BellSouth -- if AT&T did
9 get into the resale business, BellSouth's 42.54 would
10 be the same, it just benefits BellSouth in that BSE
11 could keep everybody else out of the market.

12 **WITNESS GILLAN:** That's correct.

13 **CHAIRMAN JOHNSON:** And BellSouth would not
14 have any local competition.

15 **WITNESS GILLAN:** Yes. And there would be a
16 strategic benefit to them. Even if on paper it looks
17 like they'd be indifferent between AT&T and selling it
18 to BellSouth BSE, I don't believe for a moment that
19 their management is indifferent between -- if they are
20 going to -- you know, they are going only get \$49
21 plus, whatever is the plus amount from the customer
22 anyway. I don't believe for a moment that they are
23 indifferent between the customer staying with
24 BellSouth and the customer going to AT&T or MCI or
25 anybody else who then ultimately will begin the

1 process of trying to move these customers off of the
2 network, reduce their expenses, et cetera.

3 CHAIRMAN JOHNSON: Okay. And you're
4 suggesting that if the unbundled network element
5 process, or prices, were priced in such a manner that
6 AT&T was in that market, then there would not be any
7 advantage one way or the other.

8 WITNESS GILLAN: If they were priced
9 correctly, and accepting for the moment that they
10 are -- although I think there are some issues there --
11 then there would be no advantage.

12 In fact, I think -- I will tell you today
13 that if you were to tell BellSouth BSE that they could
14 have a certificate but they had to use network
15 elements and they had to operationalize them and they
16 had to let people use them in a combined fashion, I
17 would remove any objection to you putting this company
18 in the marketplace. Because then, at least, it would
19 be on that level playing field that they say they want
20 with everybody else.

21 COMMISSIONER GARCIA: Repeat that, please.

22 WITNESS GILLAN: If you were to tell them
23 that they can have their certificate but they have to
24 compete using network elements like others, and that
25 they have to then operationalize ways for people to

1 really use network elements on a commercial scale, I
2 would remove my objection. And I'll see if I have any
3 clients when I get off of here.

4 Because that's what this is about. They say
5 they want to be on a level playing field. Well,
6 that's the only way I've ever identified that even
7 conceivably puts people on a level playing field.

8 COMMISSIONER JACOBS: Other than the idea
9 that entrants -- companies who gain entry by resale
10 are getting an inferior mode of entry, are there any
11 other benefits that the incumbent LEC gets by
12 proposing this form of subsidiary to do local service?

13 WITNESS GILLAN: I've never been able to
14 sit down and make an exhaustive list of all of the
15 advantages this would give the incumbent. I've
16 identified, as I said, the fact that this would allow
17 them to reduce the price that customers pay without
18 actually offering a wholesale rate that's below it.
19 It would give them an opportunity to capture customers
20 in the contracts that they wouldn't have to resell.
21 It would give them an opportunity to say there's
22 competition through resale even though nobody else can
23 really match the financials.

24 I'm sure if I sat here and went on for --
25 and actually talked to Mr. Scheye in depth about it, I

1 would discover more and more things they will get
2 accomplished by having -- being able to step into the
3 role of an ALEC while still being BellSouth. But I've
4 never done an exhaustive inventory of that. And
5 that's what I understood your question to be.

6 **COMMISSIONER JACOBS:** The premise of your
7 position is that BellSouth is one and the same
8 company. And if you carry that to its extension, they
9 should incur -- any activity BellSouth should incur
10 the restrictions and the costs that are imposed upon
11 them by the Act and by our statutes. Is that a fair
12 statement? In competing with other companies?

13 **WITNESS GILLAN:** Yes. In effect. Although
14 I don't want that to be interpreted that I would be
15 opposed to BellSouth having more retail flexibility
16 if, in fact, they truly were creating a level playing
17 field which others could use to provide service on the
18 same basis. I know I'm going to sound like Johnny One
19 Note, but it's always going to come back to using
20 network elements in a commercially feasible way.

21 So I could support them having less retail
22 regulation if there was, in fact, competition. This
23 to me is the worst of all worlds. No real competition
24 and retail decision of the incumbent.

25 (Transcript continues in sequence in Volume 2.)